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SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1955

No. 74

UNITED STATES OF AMERICA, PETITIONER

vs.

LESLIE SALT CO.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED MAY 16, 1955
CERTIORARI GRANTED JUNE 6, 1955

No. 13873

United States
Court of Appeals
for the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

LESLIE SALT COMPANY,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Northern District of California, Southern Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—8-14-53

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS

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San Francisco, California;

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For Appellee.

District Court of the United States for the Northern District of California, Southern Division

No. 30871

LESLIE SALT COMPANY,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

EXCERPTS FROM CIVIL DOCKET

1951

Sept. 12—Filed complaint, issued summons.

Sept. 14—Filed Summons Ret. Ex. Sept. 13, 1951.

Nov. 7—Filed answer of defendant.

1952

Nov. 24—Ordered assigned to Judge Goodman for trial this date.

Nov. 24—Court trial Arguments heard, exhibits introduced and case ordered submitted on briefs to be filed 10-20-10 days. Case set Jan. 6, 1953, for subm. (Goodman.)

1953

Jan. 13—Ordered case now submitted.

Jan. 29—Filed memo. decision of court. (Judgment for plaintiff. Findings, conclusions and judgment to be prepared pursuant to rules.) (Goodman.)

Feb. 3—Filed plaintiff's proposed findings & conclusions.

1953

Feb. 17—Filed defendant's proposed findings of fact.

Mar. 2—Filed findings & conclusions.

Mar. 2—Filed judgment for plaintiff vs. deft. in sum $4400.00 with interest from Oct. 24, 1950, and costs.

Mar. 3—Entered judgment. Mailed notices.

Mar. 5—Filed memo. (letter) of costs by pltff.—$15.00.

Apr. 30—Filed notice of appeal by United States.

Apr. 30—Filed appellant's designation of record on appeal.

Apr. 30—Filed statement of points upon which appellant intends to rely.

June 9—Filed order extending time for appellant to docket record on appeal to July 7, 1953.

June 11—Filed reporter's transcript of proceedings, Nov. 24, 1952.

District Court of the United States for the Northern District of California, Southern Division

No. 30871

LESLIE SALT CO.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

COMPLAINT

Leslie Salt Co., plaintiff in the above-entitled action, complains of the defendant and alleges:

I.

That this action is brought under Title 28, United States Code, Section 1346 (a) (1) for the recovery of documentary stamp taxes erroneously and illegally assessed and collected by the Commissioner of Internal Revenue from said plaintiff. Plaintiff's claim does not exceed the sum of $10,000.00, and arises under the Internal Revenue Laws of the United States as hereinafter more fully set forth.

II.

Leslie Salt Co., plaintiff above named, is now and at all times mentioned was a corporation created, organized, and existing under and by virtue of the laws of the State of Delaware, duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said state.

III.

That plaintiff seeks to recover from defendant the sum of Four Thousand Four Hundred Dollars ($4,400.00), together with legal interest thereon from October 24, 1950; that said sum of $4,400.00 represents the net amount of United States Internal Revenue documentary stamp taxes paid by plaintiff on or about the 24th day of October, 1950, solely by reason of the wrongful and illegal assessment and collection thereof by the United States Collector of Internal Revenue at San Francisco, California, as is hereafter set forth.

IV.

That on or about the 24th day of October, 1950, plaintiff received from the Collector of Internal Revenue in San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of two promissory notes in connection with the transactions hereinafter set forth; that as demanded in said notice and demand and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00; that said payment was made solely in order to avoid the penalties threatened to be assessed and asserted against said plaintiff by said Collector.

V.

That on or about the 29th day of March, 1951, and within two years after the payment of said tax, as in Paragraph IV above alleged, plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California, a claim for refund of said taxes illegally demanded and collected as aforesaid; that a true and correct copy of said claim for refund is attached hereto, marked Exhibit A, and made a part hereof; that said claim for refund was duly prepared and filed on Form No. 843 furnished to plaintiff by defendant and signed by Sheldon Allen, treasurer of plaintiff, the claimant therein; that at the time of the execu-

tion of said claim for refund said Sheldon Allen was the duly elected and acting treasurer of plaintiff, invested with full power and authority to sign said claim on behalf of plaintiff.

VI.

That on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff was dated July 20, 1951.

VII.

That no part of said documentary stamp tax paid to defendant by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded, or remitted to plaintiff, and no part thereof has been allowed to plaintiff by way of a credit against any other taxes due or claimed to be due from it to defendant.

VIII.

That under date of February 1, 1949, plaintiff did enter into a loan agreement with the Pacific Mutual Life Insurance Co. providing for a loan of $1,000,000.00 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000.00 to plaintiff; that on or about February 15, 1949, and pursuant to said agreement, plaintiff did execute and deliver to said Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York

its promissory notes dated on the face thereof February 1, 1949, in the amounts of $1,000,000.00 and $3,000,000.00, respectively; that said notes were not corporate securities or debentures within the meaning of Section 1801 of the Internal Revenue Code, but were the simple promissory notes of plaintiff evidencing its indebtedness to said insurance companies as aforesaid, and were not subject to the documentary stamp tax assessed against plaintiff by said Collector of Internal Revenue as aforesaid.

IX.

That by reason of the illegal and erroneous assessment and collection of said documentary stamp taxes from plaintiff as aforesaid, defendant became and is now indebted to plaintiff in the sum of $4,400.00, together with interest thereon from October 24, 1950.

Wherefore, plaintiff prays for judgment against defendant as follows:

1. For said sum of Four Thousand Four Hundred Dollars ($4,400.00), together with interest thereon from October 24, 1950;

2. For its costs of suit herein incurred; and

3. For such other and further relief as the Court may deem meet in the premises.

/s/ WALTER C. FOX, JR.,

CHICKERING & GREGORY,

Attorneys for Plaintiff.

Leslie Salt Company

EXHIBIT A

Form 843
Treasury Department

Claim
To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse.

- ☒ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
- ☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
- ☐ Abatement of Tax Assessed (not Applicable to Estate, Gift, or Income Taxes).

State of California,
City & County of San Francisco—ss.

Name of taxpayer or purchaser of stamps: Leslie Salt Co.

Business address: 505 Beach Street, San Francisco 11, California.

Residence .....

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: San Francisco.

2. Period (if for tax reported on annual basis.

prepare separate form for each taxable year) from ....., 19.., to ....., 19..

3. Character of assessment or tax: Documentary Stamp Tax.

4. Amount of assessment, $4,400; dates of payment, October 24, 1950.

5. Date stamps were purchased from the Government .....

6. Amount to be refunded: $4,400.

7. Amount to be abated (not applicable to income, gift, or estate taxes) .....$.....

8. The time within which this claim may be legally filed expires, under Section 3313 of Internal Revenue Code on October 25, 1954.

The deponent verily believes that this claim should be allowed for the following reasons:

Under date of February 1, 1949, taxpayer entered into a loan agreement with Pacific Mutual Life Insurance Company providing for a loan of one million dollars to taxpayer, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of three million dollars to taxpayer, each loan to be evidenced by a note of taxpayer payable to the lender. Said agreements also provided that the lenders on demand would be entitled to new sinking fund notes of taxpayer in exchange for said notes. Copies of said agreements have been delivered to the Bureau of Internal Revenue and by this reference are incorporated herein.

The Commissioner of Internal Revenue demanded documentary stamp tax in the amount of $4,400

on these two promissory notes, which has been paid, and refund of this amount is demanded upon the following grounds:

1. The promissory notes are not subject to the tax imposed by Section 1801 of the Internal Revenue Code, or any other documentary stamp or other tax.

2. The promissory notes are not debentures, or any other type of corporate security subject to any such tax.

3. The promissory notes are non-negotiable, and as such are mere contractual obligations possessing none of the attributes of a taxable corporate security.

Section 1801 of the Internal Revenue Code does not tax promissory notes and these instruments are promissory notes and nothing more. Statutory taxes like this stamp tax are to be construed strictly and imposed only upon the documents specifically designated in the statute. See United States v. Isham, 17 Wall. 496.

The notes in question must be considered by themselves alone and one cannot look through their form to their alleged substance, as the Commissioner is doing, and say that they are debentures and therefore subject to the stamp tax. In considering instruments subject to the stamp tax, the rule of looking through form to substance is not followed. In United States v. Isham, supra, Lederer v. Fidelity Trust Co., 267 U. S. 17, and numerous other cases, it has been held that in determining whether or not a stamp tax is due on

a certain document, the form and terms of the instrument are controlling.

The Commissioner claims that these notes are debentures, basing his classification on General Motors Acceptance Corporation v. Higgins, 161 F. 2d 593. The instruments in that case, however, are readily distinguishable from those involved here. The notes in the G.M.A.C. case were engraved and issued in series bearing serial numbers. There were eighty-four notes in denominations ranging from $100,000 to $1,000,000 and, with the exception of thirteen of the notes, they were payable to bearer. The notes there involved were patently debentures for all were exactly alike and carried every evidence of a debenture issue except for the absence of a trust indenture. On the other hand, in the case of Leslie Salt Co. there were only two notes given, both being in the form of ordinary promissory notes except for a reference in each note to the agreement of February 1, 1949, which sets forth the terms on which the loan was made. The whole arrangement was nothing more than an ordinary commercial transaction in the nature of a simple contract between the parties to borrow and lend money, evidenced by non-negotiable promissory notes. As such, the transaction was not an issuance of debentures or corporate securities.

Not only are these notes not debentures, but they do not constitute any other kind of corporate security. In order to be subject to the stamp tax, the instruments of indebtedness must not only be bonds, debentures, certificates of indebtedness, or

instruments bearing coupons or in registered form, but must also be such as are generally known as corporate securities. In Wilkinson v. Mutual Bldg. & Sav. Ass'n, 13 F. 2d 997, where it was held that the instruments in question were not bonds but were promissory notes, the Court said at page 999:

> "* * * We have not known of a corporate security that has not (1) negotiability; (2) a fixed or ascertainable time of full payment, and (3) a fixed sum to be repaid. * * *"

The promissory notes of Leslie Salt Co. are not negotiable because of the reference in them to the agreement setting forth the terms on which the loans were made. Under the provisions of the Uniform Negotiable Instruments Act, in effect both in California and in New York, and the decisions construing the same (see 10 C.J.S. 529 and cases cited there in note 82; 3 R.C.L. 883, 884), a reference to an agreement in a promissory note renders the note non-negotiable, for the terms of the agreement must be considered as part of each note.

Since the notes are non-negotiable, they are not corporate securities (Wilkinson v. Mutual Bldg. & Sav. Ass'n, supra) and therefore are not subject to the stamp tax.

Even if the notes in question were debentures within the usual meaning of the term, they would not be taxable because they were not "issued * * * with interest coupons or in registered form," as required for taxability by Section 1801 of the Internal Revenue Code. Moreover, not only because they are not, standing alone, of such type, but also

because they were not issued with interest coupons or in registered form, the notes could not, under the terms of that Section, fall within the classification of "instruments * * * known generally as corporate securities," as recognized by Department Regulation 26 C.F.R. 113.55. It is clear, of course, that the notes are not "bonds" or "certificates of indebtedness" within the meaning of the Section or the Regulations of the Department. Being merely promissory notes and nothing more, instruments of the type here involved are not subject to stamp tax and have not been since the repeal of that tax on promissory notes by the Revenue Act of 1924. This view is supported by the Commissioner's Special Rulings dated July 14, 1948, (Letter to Home Title Guarantee Co., 1949 Prentice-Hall Federal Tax Service, par. 76,130) and June 23, 1949, (1949 Prentice-Hall Federal Tax Service, par. 76,282).

The Section should in this case be construed to avoid double taxation upon what is, in essence, a single transaction. Since the lenders can, under the agreements in question, request the issuance of new sinking fund notes under a specified trust indenture in exchange for the notes in question, and since these new notes would, by the same token, be subject to the tax imposed by Section 1801, the Section should be construed, in order to avoid this double taxation, as not imposing a tax on the notes here involved.

Finally, the issuance of these notes involves a unique method of financing and represents a con-

sidered choice, dictated by sound legal and business reasons, as between note and debenture issues. A note issue differs in material respects from a debenture issue and such factors as relative expenses of issue, legal expenses, printing costs, terms, costs of capital and relation of fixed and other charges to other corporate obligations enter into the selection of this method of what is essentially private financing having none of the characteristics which typically render debentures attractive and salable to the general public. The convertible feature of these notes in itself represents a postponement of financing having the characteristics of debenture financing.

It is, therefore, the position of taxpayer that said notes, being non-negotiable, and on their face ordinary promissory notes, are mere contractual obligations possessing none of the attributes of a taxable security and hence not subject to the stamp tax.

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

March 29, 1951.

/s/ LESLIE SALT CO.,
By SHELDON ALLEN,
Treasurer.

[Corporate Seal.]

[Endorsed]: Filed September 12, 1951.

[Title of District Court and Cause.]

ANSWER

Now comes the United States of America, the above-named defendant, by United States Attorney and, for answer to the complaint filed herein admits, denies and states, as follows:

I.

Paragraph numbered I is denied, except it is admitted that plaintiff's claim does not exceed $10,000.

II.

Paragraph numbered II is admitted.

III.

Paragraph numbered III is denied, except it is admitted that the plaintiff paid to the Collector of Internal Revenue for the First District of California on October 26, 1950, the amount of $4,400.

IV.

Paragraph numbered IV is admitted.

V.

Paragraph numbered V is admitted, except that it is denied that any part of said taxes was illegally demanded or collected. It is admitted that the Exhibit A to the complaint is a true copy of the claim for refund filed by the plaintiff, but any statement therein contained which is not expressly admitted herein is hereby denied.

VI.

Paragraph numbered VI is admitted.

VII.

Paragraph numbered VII is admitted.

VIII.

Paragraph numbered VIII is denied, except it is admitted that under date of February 1, 1949, plaintiff entered into a loan agreement with the Pacific Mutual Life Insurance Company, providing for a loan of $1,000,000 to plaintiff and that plaintiff entered into a like agreement with Mutual Life Insurance of New York providing for a loan of $3,000,000 to plaintiff; and that on or about February 15, 1949, and pursuant to said agreements plaintiff executed and delivered to said Pacific Mutual Life Insurance Company and the Mutual Life Insurance Company of New York its certain instruments dated February 1, 1949, evidencing the loans of $1,000,000 and $3,000,000, respectively.

IX.

Paragraph numbered IX is denied.

Wherefore, the defendant, having fully answered prays that the plaintiff take nothing and that the defendant recover its costs.

/s/ CHAUNCEY F. TRAMUTOLO,
United States Attorney,

By /s/ CHARLES ELMER COLLETT,
Assistant United States
Attorney.

[Endorsed] Filed November 7, 1951.

[Title of District Court and Cause.]

MEMORANDUM DECISION

Goodman, District Judge.

26 USC 1801[1] imposes a tax of 11 cents on each $100.00 of face value, inter alia, upon all "debentures" issued by any corporation.

Plaintiff corporation owed large sums of money to certain banks. In order to fund these loans and to obtain needed working capital, it borrowed $1,000,000 from Pacific Mutual Life Insurance Company and $3,000,000 from Mutual Life Insurance Company of New York. It executed promissory notes for $1,000,000 and $3,000,000, respectively; to the two insurance companies. Simultaneously it executed agreements with the insurance companies, by which its business activities and the handling of its funds were circumscribed to protect the insurance companies and safeguard payment of the notes as therein provided.[2]

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[1] "§1801 Corporate securities.

"On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents" * * *

---

[2] The agreements were collaterally executed specifically for the purpose of safeguarding and insuring payment of the loans by the borrower to the lender. They were not the kind of collateral or trust agreements traditionally used as the foundation or basis for the issuance of corporate obligations or securities.

The Collector of Internal Revenue assessed and collected from plaintiff a tax of $4,400 upon the two notes, upon the ground that the notes were "debentures," as provided in 26 USC 1801. Plaintiff duly filed a claim for refund, alleging that the promissory notes were "promissory notes" and not debentures. This suit followed upon denial of the claim for refund.

There was a time when promissory notes issued in commercial transactions were subject to the payment of stamp taxes.[3] These taxes, however, were later repealed.[4] And now stamp taxes are payable only upon corporate securities as defined in 26 USC 1801.

Unless the two promissory notes in question are "debentures," they are not subject to the tax. No more so than the notes that plaintiff gave the banks to cover its previous borrowings.

There has been much technical discussion in the briefs, and in cases cited, concerning the meaning and definition of the term "debentures." Suffice it to say that, in my opinion, the two promissory notes are just what they purport to be, namely, obligations to repay the two insurance companies the money the plaintiff borrowed from them. They do not have the characteristics that would make them debentures, either as defined in or purposed by the statute. The Collector cannot, by some feat of catalytic baptism, turn a plain obligation to re-

[3] 42 Stats. 305. Revenue Act of November 23, 1921.

[4] 43 Stats. 352. Revenue Act of June 2, 1924.

pay a specific sum of money to a specific lender into a taxable security.

There does exist some disagreement of authority as to what, in specific cases, does or does not constitute a "debenture." The Government has cited General Motors Acceptance Corporation v. Higgins, 161 F. 2d 593 (2 Cir. 1947), and Commercial Credit Co. v. Hofferbert, 188 F. 2d 574 (4 Cir. 1951). The latter case was a per curiam affirmance of a District Court's opinion and decision, 93 Fed. Supp. 562 (Md. 1950). The facts in General Motors Acceptance Corp. vs. Higgins are different. The facts in Commercial Credit Co. v. Hofferbert are similar.

But later decisions in Allen v. Atlanta Metallic Casket Co., 197 F. 2d 460 (5 Cir. 1952); Belden Mfg. Co. v. Jarecki, 192 F. 2d 211 (7 Cir. 1951), and Shamrock Oil & Gas Co. v. Campbell, 107 Fed. Supp. 764 (N. D. Texas 1952), cited by plaintiff, appear to be more apropos and persuasive here.

Expert testimony was given here as to the meaning, particularly in the commercial world, of the term "debenture." The Government moved to strike the testimony and the Court reserved ruling on the motion. It now denies the motion. But I attach no weight to the testimony. For I hold that the issue is decidable, and I do decide it, upon the documents and the stipulated facts.

Judgment will go for plaintiff as prayed upon findings to be presented pursuant to the Rules.

Dated: January 29, 1953.

[Endorsed]: Filed January 29, 1953.

[Title of District Court and Cause.]

PLAINTIFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Pursuant to the Court's Memorandum Decision, signed and filed January 29, 1953, and Rule 5 (e) of the Rules of Court of the United States District Court for the Northern District of the State of California, plaintiff proposes the following as findings of fact and conclusions of law:

Findings of Fact

I.

That plaintiff is now and at all times herein mentioned was a corporation organized and existing under and by virtue of the laws of the State of Delaware, and duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said state.

II.

That prior to February 1, 1949, plaintiff carried on negotiations with the Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York seeking a loan from said two insurance companies; that no person or persons not employed by or a director of one of said three corporations participated in said negotiations; that said negotiations resulted in agreement as to the terms of a loan agreement with each of said insurance companies together with the terms of a prom-

issory note to evidence each of said loans; that said terms were reduced to writing by said lenders for execution; that under date of February 1, 1949, plaintiff did enter into a loan agreement as so prepared with the Pacific Mutual Life Insurance Co. providing for a loan of $1,000,000 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000.00 to plaintiff; that said agreements were collaterally executed specifically for the purpose of safeguarding and insuring payment of the loans by the borrower to the lenders; that said agreements were not the kind of collateral or trust agreements traditionally used as the foundation or basis for the issuance of corporate obligations or securities; that on or about February 15, 1949, and pursuant to said agreements plaintiff did execute and deliver to said Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York all documents required by said loan agreements, including its two promissory notes dated on the face thereof February 1, 1949, in the amounts of $1,000,000.00 and $3,000,000.00, respectively; that said notes are not engraved, and are not issued in registered form and do not have nor have they had coupons attached; that said two promissory notes are what they purport to be, namely, obligations to repay the two insurance companies the money the plaintiff borrowed from them, and do not have the characteristics that would make them debentures as said term is commonly defined

III.

That on or about the 24th day of October, 1950, plaintiff received from the Collector of Internal Revenue of San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of said two promissory notes in connection with the transactions hereinabove set forth; that as demanded in said notice and demand, and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00; that said payment was made solely in order to avoid the penalties threatened to be assessed and asserted against said plaintiff by said Collector.

IV.

That on or about the 29th day of March, 1951, and within two years after the payment of said tax plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California, a claim for refund of said taxes; that said claim for refund was duly prepared and filed on Form No. 843 furnished for plaintiff by defendant and signed by Sheldon Allen, treasurer of plaintiff, the claimant therein; that at the time of the execution of said claim for refund said Sheldon Allen was the duly elected and acting treasurer of plaintiff invested with full power and authority to sign said claim on behalf of plaintiff.

V.

That on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff was dated July 20, 1951.

VI.

That no part of said documentary stamp tax paid to defendant by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded, or remitted to plaintiff, and no part thereof has been allowed to plaintiff by way of a credit against any other taxes due or claimed to be due from it to defendant.

VII.

That debentures as said term is used and understood in business and financial circles are unsecured promises to pay, are negotiable in form, generally are printed in denominations of $1,000.00 with covenants by the borrower printed on the front or back, and are accompanied by a trust indenture providing for a trustee to protect the rights of the lenders in accordance with the terms of said indenture.

VIII.

That debentures as said term is used and understood in business and financial circles are sold as other corporate securities are sold in that there is generally a public offering through the channels

of investment bankers and investment banking groups, including dealers, and terms of the debentures and accompanying indenture are fixed by negotiation between the issuer and the buying investment banker or bankers or, in case the issue is sold by competitive bidding, solely by the issuer; that it is customary to advertise a sale of debentures by an accompanying circular or prospectus.

IX.

That debentures as said term is used and understood in business and financial circles are constantly bought and sold and otherwise traded in after issuance; that non-negotiable promissory notes of the size of the notes executed by plaintiff are not so traded in after issuance.

Conclusions of Law

I.

That this Court has jurisdiction of the subject matter and of the parties.

II.

That the instruments with respect to which the tax here involved was paid are non-negotiable promissory notes.

III.

That said instruments are not bonds, debentures, or certificates of indebtedness, or instruments, however termed, issued by a corporation with interest coupons or in registered form known generally as corporate securities, as those terms are used in

Section 1801 of the Internal Revenue Code, 26 U.S.C.A. §1801, and were and are not subject to stamp tax under that section or any other section of the Internal Revenue Code.

IV.

That the tax, the recovery of which is sought in this action, was wrongfully and illegally collected and plaintiff is entitled to recover said tax in the amount of $4,400.00, together with interest and costs as provided by law.

Dated: February 3, 1953.

/s/ WALTER C. FOX, JR.,

CHICKERING & GREGORY,
Attorneys for Plaintiff,
Leslie Salt Co.

Receipt of copy acknowledged.

[Endorsed]: Filed February 3, 1953.

[Title of District Court and Cause.]

DEFENDANT'S PROPOSED FINDINGS OF FACT

During all times hereinafter mentioned the plaintiff was a Delaware corporation with the right to do business in California and with its principal place of business located in the City and County of San Francisco, California.

On February 1, 1949, the plaintiff entered into

an agreement with the Pacific Mutual Life Insurance Co., providing for a loan of $1,000,000 and entered into a like agreement with the Mutual Life Insurance Company of New York providing for a loan of $3,000,000.

On February 15, 1949, pursuant to the agreements, the plaintiff executed and delivered to each insurance company an instrument styled "3¼ Sinking Fund Promissory Note," in the amounts of $1,000,000 to the Pacific Mutual Life Insurance Co. and $3,000,000 to the Mutual Life Insurance Company.

The agreements and the notes are by their terms interdependent. The agreements provide for the issuance of two promissory notes in the aggregate principal amount of $4,000,000, to bear interest at 3¼% per annum, to be dated February 1, 1949, and to mature February 1, 1964. The terms and provisions of the notes are set out in Exhibit A to the agreements. Each agreement specifies that the plaintiff agrees to sell and the insurance company agrees to purchase the note from the plaintiff at a specified time. Each agreement contains representations by the plaintiff, consisting of the delivery of balance sheets to the insurance companies, a brief description of the business and properties of the plaintiff, a list of corporations of which the plaintiff owns a substantial percentage of stock, etc. Each agreement specifies that it is made by the plaintiff in reliance upon the representation that the insurance company is acquiring the note for its own account and not with the view to, or

for sale in connection with the distribution thereof; "and that you have no present intention of selling or distributing said note * * *."

The plaintiff also agreed that so long as the purchaser holds one or more of the notes and the aggregate principal thereof is $300,000 or more, the plaintiff will, as soon as reasonably possible, after the receipt of a written request, execute and deliver "a trust indenture" and that such indenture shall be delivered to a bank or trust company selected by the plaintiff having a combined capital and surplus of not less than $3,000,000. The agreement further provides that after the execution of the new indenture, upon surrender of the note or notes by the purchaser, the plaintiff will deliver in exchange therefor new notes in an aggregate principal amount equal to the unpaid principal amount of the note or notes so surrendered, either in registered form without coupons or in coupon form and in printed or engraved form. The agreement contains sinking fund and prepayment provisions, optional sinking fund payments and optional prepayments. The agreement requires financial statements. It contains restrictions as to the creation of liabilities, declaration of dividends or the retirement of the plaintiff's stock or any deposition of its assets.

On October 24, 1950, the plaintiff paid to the defendant $4,400 as a documentary stamp tax on account of the issuance of said notes.

On March 29, 1951, plaintiff filed a claim for the refund of the amount of $4,400, which was rejected

by the Commissioner of Internal Revenue on July 20, 1951. This action was commenced September 12, 1951.

/s/ CHAUNCEY F. TRAMUTOLO,
United States Attorney.

/s/ CHARLES ELMER COLLETT,
Assistant United States
Attorney.

[Endorsed]: Filed February 17, 1953.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled cause, having come on regularly for trial on the 24th day of November, 1952, and the Court having duly considered the evidence and being fully advised in the premises, now finds the following:

Findings of Fact

I.

That plaintiff is now and at all times herein mentioned was a corporation organized and existing under and by virtue of the laws of the State of Delaware, and duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said state.

II.

That prior to February 1, 1949, plaintiff carried on negotiations with the Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York seeking a loan from said two insurance companies; that no person or persons not employed by or a director of one of said three corporations participated in said negotiations; that said negotiations resulted in agreement as to the terms of a loan agreement with each of said insurance companies together with the terms of a promissory note to evidence each of said loans; that said terms were reduced to writing by said lenders for execution; that under date of February 1, 1949, plaintiff did enter into a loan agreement as so prepared with the Pacific Mutual Life Insurance Co. providing for a loan of $1,000,000.00 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000.00 to plaintiff; that said agreements were collaterally executed specifically for the purpose of safeguarding and insuring payments of the loans by the borrower to the lenders; that said agreements were not the kind of collateral or trust agreements traditionally used as the foundation or basis for the issuance of corporate obligations or securities; that on or about February 15, 1949, and pursuant to said agreements plaintiff did execute and deliver to said Pacific Mutual Life Insurance Co. and Mutual Life Insurance Company of New York all documents required by said loan agreements, including its two promissory notes dated on the face thereof Feb-

ruary 1, 1949, in the amounts of $1,000,000.00 and $3,000,000.00, respectively; that said notes are not engraved, are not issued in registered form and do not have nor have they had coupons attached; that said two promissory notes are what they purport to be, namely, obligations to repay the two insurance companies the money the plaintiff borrowed from them, and do not have the characteristics that would make them debentures as said term is commonly defined.

III.

That on or about the 24th day of October, 1950, plaintiff received from the Collector of Internal Revenue of San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of said two promissory notes in connection with the transactions hereinabove set forth; that as demanded in said notice and demand, and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00; that said payment was made solely in order to avoid the penalties threatened to be assessed and asserted against said plaintiff by said Collector.

IV.

That on or about the 29th day of March, 1951, and within two years after the payment of said tax plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California,

a claim for refund of said taxes; that said claim for refund was duly prepared and filed on Form No. 843 furnished for plaintiff by defendant and signed by Sheldon Allen, Treasurer of plaintiff, the claimant therein; that at the time of the execution of said claim for refund said Sheldon Allen was the duly elected and acting Treasurer of plaintiff invested with full power and authority to sign said claim on behalf of plaintiff.

V.

That on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff was dated July 20, 1951.

VI.

That no part of said documentary stamp tax paid to defendant by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded, or remitted to plaintiff, and no part thereof has been allowed to plaintiff by way of a credit against any other taxes due or claimed to be due from it to defendant.

Conclusions of Law

I.

That this Court has jurisdiction of the subject matter and of the parties.

II.

That the instruments with respect to which the tax here involved was paid are non-negotiable promissory notes.

III.

That said instruments are not bonds, debentures, or certificates of indebtedness, or instruments, however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities, as those terms are used in Section 1801 of the Internal Revenue Code, 26 U.S.C.A. §1801, and were and are not subject to stamp tax under that section or any other section of the Internal Revenue Code.

IV.

That the tax, the recovery of which is sought in this action, was wrongfully and illegally collected and plaintiff is entitled to recover said tax in the amount of $4,400.00, together with interest and costs as provided by law.

Let judgment be entered accordingly.

Dated March 2nd, 1953.

/s/ LOUIS E. GOODMAN,
United States District Judge.

[Endorsed]: Filed March 2, 1953.

In the United States District Court for the Northern District of California, Southern Division

Civil Action No. 30871

LESLIE SALT CO.,

Plaintiff,

vs.

UNITED STATES OF AMERICA,

Defendant.

JUDGMENT

The above-entitled action came on for trial before the Court without a jury on November 24, 1952, the plaintiff appearing by one of its attorneys, Bruce M. Casey, Jr., and the defendant appearing by one of its attorneys, John G. Doll, Assistant United States Attorney, and evidence both oral and documentary having been received and briefs having been filed by both parties, and the Court having filed its findings of fact, conclusions of law, and order for judgment, and its memorandum decision; it is hereby

Ordered and Adjudged that the plaintiff Leslie Salt Co., a Delaware corporation, have judgment against the defendant in the sum of Four Thousand Four Hundred Dollars ($4,400.00) together with interest from the 24th day of October, 1950, as required by law, and for its costs and disbursements in this action, to be hereinafter taxed, on

notice, and hereinafter inserted by the Clerk of this Court in the sum of $15.00.

Dated this 2nd day of March, 1953.

/s/ LOUIS GOODMAN,
U. S. District Judge.

Approved as to form as provided in Rule 5 (d).

/s/ CHARLES ELMER COLLETT,
Assistant U. S. Attorney.

[Endorsed]: Filed March 2, 1953.
Entered March 3, 1953.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the United States of America, the above-named defendant, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on March 2, 1953.

Dated April 30, 1953.

/s/ LLOYD H. BURKE,
United States Attorney;

By /s/ CHARLES ELMER COLLETT,
Assistant United States Attorney.

[Endorsed]: Filed April 30, 1953.

[Title of District Court and Cause.]

STATEMENT OF POINTS UPON WHICH DEFENDANT (AS APPELLANT) INTENDS TO RELY ON APPEAL

The defendant, upon its appeal from the judgment entered in the above-entitled cause on March 2, 1953, intends to rely upon the following points:

1. The Court erred by holding that the instruments involved are not debentures or certificates of indebtedness, known generally as corporate securities.

2. The Court erred by holding that the instruments were not taxable under Sections 1800 and 1801 of the Internal Revenue Code.

3. The Court erred by having judgment entered for the plaintiff.

LLOYD H. BURKE,
United States Attorney;

By /s/ CHARLES ELMER COLLETT,
Assistant United States
Attorney.

[Endorsed]: Filed April 30, 1953.

[Title of District Court and Cause.]

ORDER EXTENDING TIME TO DOCKET APPEAL AND FILE RECORD

The defendant above named, having on the 30th day of April, 1953, filed a Notice of Appeal to the Court of Appeals from the final judgment entered in the above action on the 2nd day of March, 1953, and good cause appearing therefor,

It Is Hereby Ordered that the defendant-appellant may have to and including the 7th day of July, 1953, to docket the appeal and file the record on appeal herein in the United States Court of Appeals for the Ninth Circuit.

Dated June 8th, 1953.

/s/ LOUIS GOODMAN,
United States District Judge.

[Endorsed]: Filed June 9, 1953.

The United States District Court, Northern District of California, Southern Division

No. 30871

LESLIE SALT CO.,

Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,

Defendant-Appellant.

Before: Hon. Louis E. Goodman, Judge.

REPORTER'S TRANSCRIPT

Appearances:

For the Plaintiff:

CHICKERING & GREGORY, by
BRUCE M. CASEY, JR.

For the Defendant:

CHAUNCEY TRAMUTOLO, ESQ.,
United States Attorney, by
JOHN G. DOLL, ESQ.,
Assistant U. S. Attorney.

Monday, November 24, 1952—10:00 A.M.

The Clerk: Leslie Salt Company vs. United States. Will counsel please state their appearance for the record?

Mr. Casey: Bruce M. Casey, Jr.

Mr. Doll: John G. Doll.

The Clerk: Thank you, counsel.

Mr. Casey: Your Honor, I would like to make a short statement as to what the issues are, as I understand them, and what facts we intend to prove.

This is a suit for refund of Federal stamp taxes paid under protest on two instruments, purporting on their face to be only promissory notes.

The Treasury asserted a tax was due under the statute appearing at 26 U.S.C.A., Section 1801. This Section specifies certain instruments which are supposed to be subject to tax, and insomuch as it is material it provides that the tax apply, quoting from the statute:

> "On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities * * *."

After the tax was paid, Leslie Salt Co. filed a claim for refund, and the claim for refund was rejected. In rejecting [2*] Leslie's claim, the Government did not take the position that the instruments in question were bonds or that they were certificates of indebtedness, or that they bore interest coupons or were in registered form, but it did take the position they were debentures, the grounds being that the terms and circumstances under which the instruments were sold represented a type of financing similar to that accomplished by a debenture which represents financing through the medium of a public issuance of investment securities under an indenture.

*Page numbering appearing at top of page of original Reporter's Transcript of Record.

That being so, we, of course, plan to prove that the terms of these instruments are not those similar to the terms customarily appearing in debentures. We also plan to prove that the conditions and circumstances under which they were sold also bear no resemblance to the conditions and circumstances under which debentures were sold. We are going to call one witness from the Company who will state precisely what the terms and conditions were in this particular sale. We also have an expert witness who is familiar with debenture financing and is also familiar with the private placement of loans of this type, and he will explain what those conditions and circumstances customarily are. Also explain what terms are customarily found in a debenture issue.

Mr. Doll and I have gone over this case together and there are certain factual statements that are admitted on the pleadings which I want to read into the record. I would like to say [3] in passing that this case is one of first impression in this Circuit. Four cases have reached the Court of Appeals of other Circuits; two of them have gone to the taxpayer and two against.

Mr. Doll and I would both like to submit briefs. I would like permission of the Court to file my memorandum a week from today. I would also like 10 days to answer any memorandum that they want to submit.

You have an opening statement?

Mr. Doll: No.

Mr. Casey: Might as well explain and get these

facts clear that are not disputed in the pleadings. I would appreciate your checking, Mr. Doll.

It is admitted that Leslie Salt Co., plaintiff above named, is now and at all times mentioned was a corporation created, organized and existing under and by virtue of the laws of the State of Delaware, duly qualified to do and doing business in the State of California, with its principal place of business located in the City and County of San Francisco of said State.

It is also admitted that plaintiff seeks to recover from defendant the sum of $4,400.00, together with legal interest thereon from October 24, 1950; that said sum of $4,400.00 represents the net amount of United States Internal Revenue Documentary Stamp Taxes paid by plaintiff on or about the 24th day of October, 1950.

Is also admitted that on or about the 24th day of October, [4] 1950, plaintiff received from the Collector of Internal Revenue in San Francisco, California, a notice and demand for tax, wherein and whereby demand was made upon plaintiff that it pay the sum of $4,400.00 as stamp taxes due in connection with the execution and delivery by plaintiff of two promissory notes in connection with the transactions hereinafter set forth; that as demanded in said notice and demand, and on or about the 24th day of October, 1950, plaintiff did pay to said Collector of Internal Revenue at San Francisco, California, the sum of $4,400.00, that said payment was made solely in order to avoid the

penalties threatened to be assessed and asserted against said plaintiff by said Collector.

Also admitted that on or about the 29th day of March, 1951, and within two years after the payment of said tax, as in Paragraph 4 above alleged, plaintiff did file with the United States Collector of Internal Revenue at San Francisco, California, a claim for refund of said taxes illegally demanded and collected as aforesaid.

And it is admitted that a true and correct copy of said claim for refund is attached in the complaint and that said claim for refund was duly prepared and filed on Form No. 843 furnished to plaintiff by defendant and signed by Sheldon Allen, Treasurer of the plaintiff, the claimant therein; that at the time of the execution of said claim for refund, said Sheldon Allen was the duly elected and acting treasurer of [5] plaintiff, invested with full power and authority to sign said claim on behalf of plaintiff.

Also admitted that on or about the 20th day of July, 1951, the Commissioner of Internal Revenue forwarded to plaintiff a letter advising that plaintiff's said claim for refund had been rejected in full; that said notice of rejection from said Commissioner to plaintiff July 20, 1951.

Also admitted that no part of said documentary stamp tax paid by plaintiff on or about the 24th day of October, 1950, in the sum of $4,400.00, has ever been repaid, refunded or remitted to plaintiff, and no part thereof has been allowed to plaintiff

by way of a credit against any other taxes due or claimed to be due from it to defendant.

It is also admitted that under date of February 1, 1949, plaintiff did enter into a loan agreement with the Pacific Mutual Life Insurance Company providing for a loan of $1,000,000 to plaintiff, and a like agreement with Mutual Life Insurance Company of New York providing for a loan of $3,000,000 to plaintiff; that on or about February 15, 1949, and pursuant to said agreement, plaintiff did execute and deliver to said Pacific Mutual Life Insurance Company and Mutual Life Insurance Company of New York its promissory notes dated on the face thereof, February 1, 1949, in the amounts of $1,000,000 and $3,000,000, respectively.

I guess that is all that is admitted. That's all of the [6] admissions obtained in the pleadings.

Mr. Doll has been furnished with copies of the two promissory notes and also with copies of the loan agreements accompanying the notes, and two certificates which also accompanied the loan agreements. We are going, I believe, to stipulate copies may go in rather than the originals.

Mr. Doll: Yes, we will so stipulate, your Honor.

Mr. Casey: Your Honor will note on reading the loan agreements that it calls for various exhibits to be furnished by the Company. The substance of what those exhibits contain appears in the loan agreements. I thought that it would be just accumulative if I put in the exhibits themselves; it would just add to the documents that will be before the Court.

Can it be stipulated, however, that these exhibits were furnished as called for by the loan agreement?

Mr. Doll: Furnished whom?

Mr. Casey: Furnished by the borrower to the lenders.

Mr. Doll: Yes, we will so stipulate.

Mr. Casey: I would like to offer these documents in evidence. First is a document purported on its face to be a $3,000,000 promissory note executed by Leslie Salt Co. and payable to the Mutual Life Insurance Company of New York.

The Clerk: Plaintiff's Exhibit 1 introduced and filed into evidence.

(Whereupon promissory note referred to above was admitted [7] into evidence and marked Plaintiff's Exhibit No. 1.)

Mr. Casey: The second document purports to be a certificate of Leslie Salt Co. dated February 1, 1949.

The Clerk: Plaintiff's Exhibit 2 introduced and filed into evidence.

(Whereupon certificate referred to was admitted in evidence and marked Plaintiff's Exhibit No. 2.)

Mr. Casey: The third purports to be a loan agreement between the Mutual Life Insurance Company of New York and Leslie Salt Company under date of February 1, 1949.

The Clerk: Plaintiff's Exhibit 3 introduced and filed into evidence.

(Whereupon loan agreement referred to above was admitted in evidence and marked Plaintiff's Exhibit No. 3.)

Mr. Casey: The next document purports on its face to be a $1,000,000 promissory note payable to Pacific Mutual Life Insurance Company, and executed by Leslie Salt Co.

The Clerk: Plaintiff's Exhibit 4 introduced and filed into evidence.

(Whereupon promissory note referred to above was admitted in evidence and marked Plaintiff's Exhibit No. 4.)

Mr. Casey: The next document purports to be a certificate of Leslie Salt Co. which applies to the Pacific Mutual Life Insurance Company, and it is dated February 1, 1949.

The Clerk: Plaintiff's Exhibit 5 introduced and filed [8] into evidence.

(Whereupon certificate referred to above was admitted into evidence and marked Plaintiff's Exhibit No. 5.)

Mr. Casey: And the last document purports to be a loan agreement between the Pacific Mutual Life Insurance Company and Leslie Salt Co. under date February 1, 1949.

The Clerk: Plaintiff's Exhibit 6 introduced and filed into evidence.

(Whereupon agreement referred to above was admitted into evidence and marked Plaintiff's Exhibit No. 6.)

Mr. Casey: Mr. Allen, will you take the stand?

SHELDON ALLEN

called as a witness on behalf of the plaintiff; sworn.

The Clerk: Please state your full name to the Court.

The Witness: Sheldon Allen.

Direct Examination

By Mr. Casey:

Q. Where are you employed, Mr. Allen?

A. Employed by Leslie Salt Company.

Q. And what is your position with that company? A. I am Secretary and Treasurer.

Q. Are you familiar with the six documents, the originals of the six documents that have been just received in evidence? A. I am. [9]

Q. Does your signature appear on those documents? A. It does.

Q. Are you familiar with the negotiations and decisions which led up to the execution of those documents? A. I am.

Q. When did the plaintiff in this case, Leslie Salt Co., first decide to borrow the money that is evidenced by the documents that have been received in evidence?

A. It was decided to borrow the money, or the decision was made approximately October 1, 1948.

Q. At that time, was there any discussion as to borrowing from a bank or to issue bonds rather than to borrow from any insurance company?

A. At that time we had outstanding $2,000,000 of revolving credit, bank loans, and of course the

(Testimony of Sheldon Allen.)

matter of extending and increasing the amount of those loans was discussed, and the possibility of issuing annuity securities, such as convertible preferred stock was also discussed.

Q. Why didn't the bank—rather the plaintiff—borrow from the bank and also why did it decide not to issue bonds or preferred stock?

A. Well, of course——

Mr. Doll: I must object to that, your Honor. I don't believe that is particularly material.

Mr. Casey: Your Honor, please, as I stated earlier, the [10] Treasury took the position that the condition and circumstances surrounding the execution of these two promissory notes showed that they were not of mere promissory notes, but were also similar to a type of financing represented by the public issuance of debentures. That being their position, I certainly think, to meet the burden of proof, it is up to me to show what exactly were the conditions and circumstances surrounding the execution of the documents, and I can't confine myself just to the documents themselves. That is the materiality of this line of questioning to the witness right now.

The Court: But counsel, isn't the only question what they did rather than what they talked about? When you speak of facts and circumstances surrounding the transaction, doesn't that just connote the circumstances that comprised the facts, rather than——

Mr. Casey: Your Honor, I think it is not only

(Testimony of Sheldon Allen.)

what they did, but why they did it that is material.

The Court: Yes, if that is the Government's position, I would be inclined to hold against them, because I don't think it makes any difference why they did it.

Mr. Doll: That is our position.

The Court: I suppose that they must have needed the money, that is obvious; they wanted to get some money, so decided to go through with this procedure. What is the materiality of the mental processes as expressed in conversations or the [11] decisions among themselves; what has that to do with it?

Mr. Casey: Well, I think, your Honor, when a company is making a decision to borrow money there are certain circumstances which affect that decision which have a materiality.

The Court: I can understand that, but I would think that would be developed necessarily by the discussions; they probably considered the cost and expenses——

Mr. Casey: Precisely.

The Court: ——the problems that go into financing, but that wouldn't necessarily be shown by what the conversations were, that is all. The witness could be examined; and another witness could testify as to what are the costs and expenses involved in the different types of financing; the Court could draw its own conclusion that ordinarily American businessmen are prudent and they follow a course that is least expensive, if they could get the money

(Testimony of Sheldon Allen.)

that way. I think that is all that is involved in that.

I will sustain the objection on the ground that it calls for hearsay discussions.

Q. (By Mr. Casey): In any event, you did decide to borrow from the two insurance companies?

A. That's correct.

Q. Was this a unique transaction on their part, or are they in the business of making commercial loans to manufacturers of this type? [12]

A. I am unable to state whether they are in the business. I know that they do make loans to other commercial manufacturers.

Q. Who made the first approach as between insurance companies and Leslie Salt Company with respect to execution of the loans?

A. The loan contact was made by one of our directors, Mr. Jasper W. Tulley.

Q. Were the services of an investment banker employed as an agent in the negotiations, or were all negotiations carried out directly between the company that borrowed and the insurance companies?

A. The negotiations were carried on direct by the company and the representative of the lender.

Q. Did you negotiate with any other insurance companies with respect to these two loans?

A. No.

Q. Who prepared and presented the first document or letter presenting the proposed terms of the loan?

A. An employee of the insurance company. The

(Testimony of Sheldon Allen.)

one, New York Mutual Life Insurance Company of New York, prepared a memorandum early in December, 1948, outlining in general the terms of the loan agreement.

Q. Were there any subsequent directives or documents prepared prior to the final execution of the instruments——

A. Yes, they printed up a form of note, form of certificate, form of loan agreement, sent them to us in the form of proofs. [13] Actually, numerous changes were made before the final papers were drawn.

Q. In other words, they were taking the affirmative and preparing terms, they would present the terms to you and then you would discuss them after they had submitted their first proof?

A. That's right.

Q. Where were the loans closed?

A. At our office in San Francisco.

Q. I suppose there was the usual exchange of documents at that time? A. That's right.

Mr. Casey: I believe that is all I have, Mr. Doll.

Mr. Doll: No questions.

The Court: That is all.

(Witness excused.)

Mr. Casey: Mr. Beckett, will you take the stand?

JOHN R. BECKETT

called as a witness on behalf of the plaintiff. Sworn.

The Clerk: Please state your full name to the Court.

The Witness: John R. Beckett.

Direct Examination

By Mr. Casey:

Mr. Beckett, will you please state your [14] educational background?

A. I received my A.B. from Stanford University in 1939 and an M.A. from that institution in 1940, majoring in both instances in finance and economics.

Q. What has been your business experience since your graduation?

A. Upon receiving my M.A. degree I was employed by the Pacific Gas and Electric Company to do financial studies in conjunction with the Sacramento Condemnation Case which was then in progress.

In 1941 I moved to Chicago with a firm called Duff and Phillips, which firm specialized in financial studies concerning utilities for the larger financial institutions across the country, such as insurance companies and banks.

In 1942 I went with the Securities and Exchange Commission as financial analyst expert.

In 1943 I was employed by the Seattle Gas Company as assistant to the president, primarily in charge of that company's financial matters and af-

(Testimony of John R. Beckett.)

fairs, and in 1944 I went with Blyth and Company in New York.

Since 1944 I have been employed with Blyth and Company in conjunction with their new issue business, the buying department. I have traveled extensively for Blyth and Company as a financial expert and I have had the sole responsibility for technical work for Blyth and Company for issues of securities [15] which in the aggregate come to many hundreds of millions of dollars.

I am past president of the Securities Analysts of San Francisco and past vice-president and director of the National Association of Financial Analysts Society.

Q. For the purpose of the record, Mr. Beckett, what business is Blyth and Company engaged in?

A. Blyth and Company are primarily underwriters of securities.

Q. They have offices in addition to their office here in San Francisco?

A. We have 28 offices throughout the United States, and are one of the major factors in the business.

Q. Mr. Beckett, have you done work in conjunction with the public sale debentures and the private sale of notes to financial institutions?

A. I have worked on bond debentures which have been sold to the public and on private placements of notes with insurance companies. And in the latter connection, I have prepared for our company a number of studies, including one study

(Testimony of John R. Beckett.)

which we issue to the public nationwide, the service to banks and insurance companies, and also to companies considering private placement transactions.

Q. Based upon your experience and based on your understanding of the terms debentures and notes, as those terms are used in business and financial circles, will you please describe the [16] differences in terms between debentures and notes?

Mr. Doll: Your Honor please, I must object to this line of questioning, because the facts here are uncontradicted as to the agreements, as to the notes, and we feel that the Court should not resort to extrinsic evidence on a stamp tax controversy to change the face of the instrument. That is, the Government contends that these notes are subject to tax and in making that decision we should rely simply on the notes themselves, on the agreements and on the circumstances surrounding that. And evidence such as that attempted to be introduced now is superfluous.

I want to call to the Court's attention the case of Motter vs. Bankers Mortgage Co. of Topeka, Kansas, 93 Fed. 2d 778. The Court stated on Page 780:

> "Whether obligations are corporate securities within the meaning of the statute is a mixed question of fact and law to be determined by the provisions in the instruments themselves, face and form of the certificate or bond, and the circumstances under which they were issued. When facts are thus ascer-

(Testimony of John R. Beckett.)

tained, then it becomes a question of law as to whether they are corporate securities within the terms of the statute. The Court of Claims——"

in Fidelity Investment Association vs. the United States, 5 Fed. Suppl. 19, [17]

"——declared that the nature and character of an instrument, doubtful in characteristics and appearance is a question of fact and approved the admission of expert testimony bearing thereon, but where the instrument is plainly and patently on its face a secured indebtedness, oral evidence would be superfluous. These instruments are plainly and patently secured obligations, conditional and contingent in nature. Expert testimony as to how they are commonly denominated and regarded by those engaged in the purchase and sale of securities, being entirely superfluous, had no proper place for consideration in the trial below."

I also want to cite United States vs. Isham, 17 Wallace 496. The Court said on Page 505:

"It is not permissible to the Courts nor is it required of individuals who use the instrument in their business, to inquire beyond the face of the paper. Whatever upon its face it purports to be, that it is for the purpose of ascertaining the stamp duty."

And therefore, your Honor, I feel that any testi-

(Testimony of John R. Beckett.)

mony along these lines is superfluous and inadmissible.

The Court: What does the statute say? Have you got that handy?

Mr. Doll: Yes, your Honor. It is Section 1801 of Title 26. [18]

The Court (Reading to himself): Well, if there is a question as to whether or not a document is known generally as a corporate security, wouldn't that become an issue of fact?

Mr. Doll: Well, I believe—our position, your Honor, is that there is no question as to the interpretation of the agreements and of the notes. They are clear, they are inadmissible, and then there is a legal question as to whether or not those notes are debentures within the meaning of the Act.

The Court: You mean that the Court would have to preliminarily determine whether or not the documents needed interpretation as securities as generally known, that if it first is decided that that interpretation is made, then there isn't any question of fact to be determined?

Mr. Doll: Yes, your Honor, that is our position. And in this case, as I understand it, there is no ambiguity in the instruments, there is no question as to what they mean; then it is a question of law as to whether or not those notes are debentures within the meaning of the Act, and we would then rely on the cases that have already been decided in interpreting the term debentures within the meaning of that section.

(Testimony of John R. Beckett.)

The Court: If they are debentures, then there is no need, you say, for any other evidence. Is that what you mean?

Mr. Doll: That is right.

The Court: If they are debentures.

Mr. Doll: Yes, your Honor. [19]

The Court: If that is the question, it becomes necessary to determine whether they are generally regarded as securities; then it would be proper for the Court to hear that evidence.

Mr. Doll: Well, I think it is not a question as to whether or not these agreements are generally regarded as debentures or securities, by security analysts; it is not a question of that at all. In fact, it is a question as to whether or not they are debentures within the meaning of that legal term.

The Court: No, maybe I didn't make myself clear. I notice that the statute refers to classes of documents.

Mr. Doll: Yes.

The Court: It says there should be a tax on all bonds and debentures and on securities of indebtedness. Then it goes on and says on all instruments however termed, issued by a corporation with interest coupons or in registered form, known generally as corporate securities. So that if an instrument is a bond or a debenture or certificate of indebtedness it is your contention that, and that is so termed, there is no further inquiry to be made?

Mr. Doll: That is right, your Honor.

(Testimony of John R. Beckett.)

The Court: But if it is not a bond or a debenture or a certificate of indebtedness there—but it is claimed to be taxable, subject to the stamp tax because it is an instrument that is termed, that is, has coupons attached or in registered form known as a corporate security. [20]

Mr. Doll: It is our contention, your Honor, these instruments are debentures within the meaning of the statute.

The Court: Well, they haven't got any interest coupons and they are not registered, in registered form?

Mr. Doll: Yes.

The Court: On the face of it.

Mr. Doll: That is right.

The Court: No dispute about that.

Mr. Casey: Certainly not.

The Court: So would they have to have those two in issue in order to——

Mr. Doll: No, your Honor.

The Court: ——to be taxed subject to the stamp tax as corporate securities?

Mr. Doll: Yes, in order to be taxed as corporate securities they would have to be in registered form and have coupons attached, at that section has been interpreted as being in the alternative that debentures can be taxed and need not be in registered form or have coupons attached.

The Court: Well, what does the Court have to have before it in order to determine whether the documents are debentures?

(Testimony of John R. Beckett.)

Mr. Casey: That is a point I have in mind, too, your Honor. It seems to me that Mr. Doll is asking us to take judicial notice of what terms customarily appear in a debenture. Incidentally, I have a number of cases I would like to discuss [21] when Mr. Doll is through.

The Court: What is this witness going to testify to, what is the purpose of his testimony? Perhaps I can rule more intelligently if I know what it is.

Mr. Casey: Yes, your Honor.

This witness is going to testify, number one, as to what terms appear in the debenture issue with which he is familiar. He is also going to testify as to the conditions and circumstances under which debenture issues commonly are marketed to the public. Both those points are material, according to the position that the Treasury has taken since 1947. Mr. Doll's cases, you will note from the citations, were all prior to that time. If your Honor please, I would like to quote from a regulation that came out by the Treasury in 1947. Incidentally, I would like to say that in 1947——

The Court: Before you get on to that; what precisely is this witness going to testify to, what is the nature of his testimony going to be? I presume you know that.

Mr. Casey: Yes, your Honor.

The Court: You, no doubt, have talked to him about it.

Mr. Casey: He is going to testify as to the type

(Testimony of John R. Beckett.)

of restrictive relations that appear in a debenture; also going to say debenture issues are commonly sold under an indenture, a trustee being a party to the debenture, and the trustee, of course, being in that position to protect the rights of the [22] debenture holders. He is also going to testify as to the denominations customarily found on debentures.

The Court: Is he going to give a definition of debentures as he understands them, or is that something that has been legally determined?

Mr. Casey: I believe that there is no precise legal definition of the term. In the discussions since 1947 of what is and what is not a debenture primarily reliance has been placed on how they are sold, what happens to them when they are sold. I don't know that you can fix it any more clearly than that. In other words, circumstances would have weight one way or another.

The Court: Well, I suppose there is some difference between a debenture and a promissory note; both, of course, are promises to pay money.

Mr. Casey: Certainly.

The Witness: In a certain sense.

Mr. Casey: They have similarities; they also have differences.

The Court: Well, I think it would probably save time, Mr. Doll, if all this witness' evidence should go in, subject to motion to strike.

Mr. Doll: I would like the record to show——

The Court: The court would be better able to

(Testimony of John R. Beckett.)

rule on these, on your objections, because it probably goes somewhat [23] to the heart of the case anyway.

Mr. Doll: To summarize my objection, your Honor, it is simply that debenture is a legal term and it has been dealt with by the Courts in many cases, and it is not up to the security analysts to tell the Court what debentures are, but the Court should so decide relying on the law in the numerous cases dealing with that term in the past and with the history of the Acts which also affect the term.

The Court: Well, I suppose his testimony is going to be very brief.

Mr. Casey: Certainly is.

The Court: I will allow the testimony to go in subject to a motion to strike, and reserve ruling on it.

Mr. Casey: Your Honor, in view of the fact that this question has come up, though, I would like permission to recall Mr. Allen. I think I would like to put in the letter from the Treasury rejecting our claim for refund so that the grounds of their rejection will appear.

The Court: You don't need to recall him for that. There is no question about the authenticity of the letter.

Mr. Doll: No.

The Court: Just offer it in evidence.

Mr. Casey: I am offering it for the purpose of showing the relevancy of this testimony here.

(Testimony of John R. Beckett.)

The Court: All right, put it in. [24]

Mr. Casey: In view of the motion to strike.

I offer a document purporting to come from the United States Treasury Department under date of July 20, 1951, and addressed to the Leslie Salt Co.

The Court: That is the rejection of the claim?

Mr. Casey: The claim is rejected, stating the grounds.

The Clerk: Plaintiff's Exhibit 7 introduced and filed into evidence.

(Whereupon Rejection of Claim Letter referred to above was admitted in evidence and marked Plaintiff's Exhibit No. 7.)

Q. (By Mr. Casey): Mr. Beckett, I believe that we had gotten to the point where I had asked you to describe the difference in the terms customarily appearing in instruments purporting to be debentures as contrasted with instruments purporting to be notes, as those terms are understood in business and financial circles?

A. Both debentures and notes are unsecured promissory payments to pay. But in the case of a debenture, an indenture is prepared in connection with the issue, which indenture contains a number of protective provisions. Provision is likewise made for an independent trustee to see to it that the terms of the indenture are fulfilled. Restrictive terms contained in a debenture issue are usually less severe than those contained in notes sold to private buyers.

(Testimony of John R. Beckett.)

On the other hand, while notes sold privately to a private [25] buyer or a group of buyers contain protective features, no trustee is created, since none is needed, as a note issue is not widely held or traded in. Protective features for notes sold privately are usually less severe—are usually more severe than for debentures sold publicly.

As to the mechanics——

Mr. Doll: The witness is reading from some notes; might I take a look at those?

Mr. Casey: Certainly.

The Witness: You certainly can.

Mr. Doll: Were these prepared by yourself for use at this trial?

The Witness: They were prepared by myself for use at this trial.

Q. (By Mr. Casey): Mr. Beckett, will you please describe the mechanics of the sale of debentures and of the sale of notes?

A. Debentures are usually sold to the public by public offerings. These are to be offered through the channels of investment bankers and investment banking groups and investment dealers. In other words, there are usually many individuals and houses interested in the offering to the public, which offering is usually made in units of $1,000 pieces of paper, or in multiples thereof.

Incidentally, one reason for the necessity of a trustee in the case of debenture is to protect the many holders [26] resultant from public sale. On the other hand, notes sold privately to insitutions

(Testimony of John R. Beckett.)

have most of the characteristics of a loan made with a bank and the investment banking channels are not required. Sometimes the investment banker is used in the sale of privately placed notes, but then he is only employed as a financial agent. He does not use his capital or his distribution facilities. Notes sold privately are not usually sold in units of $1,000, and as I have mentioned, there are no trustees.

Many issues placed privately do not employ the system of investment bankers, which is in direct contrast to the public sale of debentures, in that the issuer and the borrower negotiate the agreement without the services of the investment banker, even as a financial agent. It is my understanding this was the case in conjunction with the note issue currently under consideration.

While discussing this phase of the subject, it might be interesting to point out that a note placed privately with an insurance company or a bank loan are each covered by agreements setting forth certain restrictions on the issuer, setting up the rights of the buyer and providing for repayment of the credit, and the only fundamental difference between a bank loan and an insurance company note seems to lie in the fact that the insurance companies are in a position to extend longer maturities than can a commercial bank. It might be that the [27] factor of similarity between an insurance note and a bank note will be of aid in distinguishing the private placement from the bond or debenture.

Q. (By Mr. Casey): Mr. Beckett, you said in-

(Testimony of John R. Beckett.)

surance companies are usually in a position to extend credit over longer periods than are commercial banks. Is that invariably the case, or do sometimes commercial banks extend credit for say 10 to 15 years?

A. To my knowledge there has been no commercial bank extending credit up to 15 years, in recent years. Some of the commercial banks will make loans from 7 to 9 years, which are about as long a maturity you can get from a commercial bank. They don't like to make a loan of that duration.

Insurance companies usually pick up where the banks leave off, and will make loans of a duration from 9 to 25 years, or even up to a hundred years.

Also an insurance note and a bank note are made a part of the same transaction, the banks taking an early maturity, let's say, the first five years, and the insurance company the next ten maturities, or the next 10 years, let's say, for a 15 year note. That is a very common practice, where the banks take early maturities, insurance companies take the later maturities. On such a note issue the restrictive provisions securing that note issue are identical for the bank and the insurance company.

Q. Will you describe how restrictive provisions are [28] negotiated for debentures and notes?

The Court: I don't see any point to how they are negotiated; what has that got to do with it? Again it is what is done that counts. That involves a long discussion.

Mr. Casey: Yes, your Honor.

(Testimony of John R. Beckett.)

The Court: Operating, financing, and so forth. I don't see that helps this case.

Mr. Casey: The point I was going to bring out, your Honor, is that insofar as the provisions that appear in the loan agreement that has been introduced in evidence, that was the result of direct negotiations between the buyer and seller.

The Court: That would be true in any agreement in connection with any financing.

Mr. Casey: No, your Honor, I don't believe that is the case. If I go out into the market and——

The Court: Somebody has to negotiate an agreement if they are debentures or what they are. What difference does that make?

Mr. Casey: I would like to be heard a moment more on that. If I buy a debenture on the market, I don't negotiate at all; the terms are already set up.

The Court: I understood you to say that you were talking about the negotiations leading up to the establishment of the documents, the making of the documents on which debentures are issued. Somebody has to negotiate the transaction. I assumed [29] that is what you are referring to.

Mr. Casey: Somebody has to negotiate the terms in a private placement of a note, no question about that.

The Court: They have to negotiate the terms in a public placement, too, somebody has to devise the instrument.

Mr. Casey: That is right.

The Court: On which the debentures are issued.

(Testimony of John R. Beckett.)

Mr. Casey: You are quite correct. But I meant there was no negotiations between seller and borrower; the terms are already fixed before the borrower makes up his mind to lend the money or refuse to lend the money. In other words, his choice is to buy or sell, he doesn't have any choice insofar as changing provisions in the agreement.

The Court: Nothing to stop the insurance company here if it wanted to issue its own obligations or an interest in a note which it had, the insurance company could issue or sell fractional interests in, this, couldn't it, provided it complied with all the regulations of the State or Federal Government in that regard?

Mr. Casey: The insurance company could assign.

The Court: If they did that, then what it issued would probably be called debentures, without any question.

Mr. Casey: If your Honor has read that Company agreement you will find that there is a provision for the creation of the, or the substitutions of debentures. If the borrower wanted [30] to—If the insurance companies wanted to, they could have insisted at a later time that a new provision come into effect which involved the creation of the debenture.

The Court: Well, the insurance company had an agreement which contained many provisions with respect to governing the relationship between the borrower and the lender. And now, there would be nothing to stop the insurance company from dis-

(Testimony of John R. Beckett.)

posing of its interest as the lender in the form of notes which it might sell, provided it complied with the applicable Federal or State regulations.

Mr. Casey: That is right, there would be nothing to stop it, but I think it would certainly be a different situation that occurs when you have an issuance of debentures that are offered to the public.

The Court: Well, they are capable of being offered to the public by the insurance companies.

Mr. Casey: It can't offer these two notes.

The Court: Well, divide it up.

Mr. Casey: Well, I think the—entirely new documents would have to be executed.

The Court: That is right.

Mr. Casey: Before it could do so. That seems to me to be a significant difference.

The Court: Well, if it could do that, then why wouldn't the issue—why wouldn't the one note be a debenture then? [31]

Mr. Casey: Why wouldn't the one note be a debenture?

The Court: Yes.

Mr. Casey: Because Mr. Beckett, as you recall, your Honor, said that when a debenture is issued it is accompanied by an indenture to which a trustee is a party. There is no such document in connection with this note as far as——

The Court: You say it is essential that before an obligation shall be called a debenture there has to be a trustee?

Mr. Casey: I will make the contention, yes, your

(Testimony of John R. Beckett.)

Honor, I certainly will; I think that is the fact that all debentures——

The Court: Couldn't there be other means of enforcing the terms made without the necessity of having a trustee?

Mr. Casey: Well, in this note here the lender is the one who is going to enforce his provisions, no need for a trustee here, because we have no wide market where there are several lenders involved rather than just two. If I sell to the public naturally a trustee is going to be needed and the public is in no position to protect itself.

The Court: I guess we are getting a little far off in the argument here. The question that has been asked, I don't quite see the materiality of the question of the negotiations concerning the matter.

Mr. Casey: Perhaps, your Honor, I should have done this before, cited a couple of cases. [32]

The Court: Never mind about that, let's get the record completed and then make all the argument that you consider necessary.

Ask another question, or reframe it so we can move along with the testimony.

Mr. Casey: I didn't understand, your Honor.

The Court: I say, would you mind either repeating that question or asking another question?

Mr. Casey: All right.

Q. (By Mr. Casey): Mr. Beckett, will you describe how restrictive provisions are created for debentures and notes?

A. In the case of debentures, the terms of the

(Testimony of John R. Beckett.)

indenture are created by the negotiations of the issuer and the buying investment banker. Or, in the case of a competitive bid for debentures solely by the issuer. When debentures are offered to the public the terms are fixed and the buyers of the debentures either buy or refuse to buy based on the terms of the issue.

On the other hand, notes which are privately placed bear terms fixed by the lender and the borrower by direct negotiation.

Now, one of the terms usually contained in a private note is a provision that the note is being purchased for investment and not for resale. However, in case the purchaser of said note decides that he wishes to resell a portion of said note, provision is usually made so that an indenture will be created and [33] that the note will be broken down into pieces which can be sold to the public, and when such indenture is created and a debenture created and the piece is sold to the public, I would assume at that time that the instrument had changed and had become a debenture and would be taxable.

Q. Mr. Beckett, will you explain the characteristics of after markets for debentures and notes?

A. Since debentures are sold to the public, it is characteristic of a debenture issue that public trading takes place following the initial distribution; and there is a known after market after such initial distribution. Buyers of the debentures, therefore, know from day to day or from week to week what their investment is worth based upon public conditions.

(Testimony of John R. Beckett.)

The issuer of the debentures is likewise in a position to buy said debentures in the open market, often, if interest rates have changed, at a discount from the original issue price.

On the other hand, notes placed privately have no after market and no public trading, and in fact, the buyer of a private note usually warrants in the loan provisions that he is buying such note for investment and not resale. There is no possibility in the case of a private note for the issuer to buy at a discount.

Q. Is it possible to amend restrictive provisions incorporated into debentures and notes?

A. It is possible in each instance, though much more difficult [34] in the case of a debenture, because of the widespread distribution of the instrument as compared with a privately placed note where you can sit down and negotiate the provisions in case of change.

Q. Will you describe the differences in sales methods of debentures sold publicly and notes privately placed?

A. Debentures sold to the public are usually sold by the investment banking profession as above outlined through the use of a circular or prospectus and in fact, a public offering of any size, the prospectus, which is part of the registration statement, is filed with the Security and Exchange Commission.

One of the characteristics of the debenture is that considerable time and expense is taken in preparing it for public offering, including the preparation of the registration statement.

(Testimony of John R. Beckett.)

In contrast, notes sold privately are not sold by means of prospectus or circular, and to my knowledge no notes have ever been sold privately which have been registered with the Securities and Exchange Commission.

The private sale of a note can be accomplished much more quickly than a public sale of a debenture, and a much more easier transaction to accomplish, and this is one of the advantages of the private sale.

Of course, the disadvantage of the private note sale as compared with the public sale of debentures is that a company's [35] credit is enhanced publicly by public sale, and the name of the seller becomes better known across the country.

Q. As a matter of practice, Mr. Beckett, do those selling debentures customarily attempt to obtain clearance from State Blue Sky Laws?

A. It is customary to obtain clearance from State Blue Sky Commissions, which is in contrast to the sale of notes privately.

Q. Do those selling debentures customarily attempt to obtain opinion of legal counsel as to the legality of the investment in the issue?

A. Because the debenture sale is offered usually through the several states to a wide buying audience, legal opinions are made and advanced as to whether the instruments are proper investments for financial institutions. This is in contrast to the sale of notes.

Incidentally, on that point, I would like to state

(Testimony of John R. Beckett.)

that while the debentures are occasionally sold privately to insurance companies as debentures, not as notes, so that there have been instances when debentures have been sold privately to insurance companies without the procedures as above-mentioned, but sold as debentures so that resale may be accomplished by the insurance companies without going through the creation of the indenture and these other things which I have talked about.

Q. What is the difference in appearance between a debenture and a private note? [36]

A. Debenture certificates are usually prepared in a form to be negotiable and have the word "debenture" printed on them, or engraved, together with restrictive covenants.

Q. Let me interrupt you. You mean that the restrictive covenants appear on the debenture itself?

A. Very often they appear on the backside of the debenture, much as preferred stock articles appear on the backside of the preferred certificates.

Q. Have you read the loan agreements between Leslie Salt Company and the Mutual Life Insurance Company of New York and the Pacific Mutual?

A. I have examined such agreements.

Q. In your opinion, do the notes, agreements and accompanying notes conform to such standards as to make the issue a debenture issue as that phrase is used in business and financial circles?

The Court: Well, of course, I have great re-

(Testimony of John R. Beckett.)

spect for the opinion of this gentleman in testifying, but I don't think that is the problem.

Mr. Casey: Only accumulative, your Honor. Withdraw the question.

That is all I have from Mr. Beckett.

The Court: Do you want to examine the witness or do you want to make a motion to strike?

Mr. Doll: I would like to make a motion to strike the [37] testimony. I would also like to request of counsel a copy of the notes that were used in connection with Mr. Beckett's testimony.

Mr. Casey: Certainly. I don't have it right now; I will get you one.

The Court: I will reserve ruling on the motion to strike.

Mr. Doll: Yes, your Honor.

The Court: I don't think there is anything particularly about the testimony that is so vital that the case would have— —

Mr. Casey: Certainly the whole thing ought to be briefed together on the motion to strike.

The Court: Is there anything further? Would you like to ask any questions?

Mr. Doll: There are just two brief questions I would like to ask Mr. Beckett.

Cross-Examination

By Mr. Doll:

Q. One is, did you or the Blyth Company have anything to do with the issue of the notes in question? A. No, we did not.

(Testimony of John R. Beckett.)

Q. And you were called in on this just after you were consulted by counsel for the plaintiff, after the notes signed and so on just in connection with this case?

A. Just in connection with this case.

Q. The type of financing that we have in question here, a large sum of money, loaned by insurance companies to a [38] corporation for a relatively long period, is that a well-established type of financing, or is that a method of rather recent origin?

A. It is a method of rather recent origin if you consider the years—1947, I guess is when it became in considerable vogue, if my recollection is right, approximately 18 per cent of the corporate flow in the year 1947, was done through private methods. It is now probably 50 per cent of the corporate flow that is done through private placement. It is a very sizeable portion of the corporate flow.

Mr. Doll: That is all.

The Court: That is all.

Mr. Casey: I would like to ask one more question.

Redirect Examination

By Mr. Casey:

Q. You have examined these two notes and accompanying agreements and state that you are familiar with several other similar type loans. Is there anything unusual about this particular transaction compared to other transactions of the same size between insurance companies?

(Testimony of John R. Beckett.)

A. It is the most usual transaction for the time in which it was made. Provisions change as styles change, and the loan made today will be somewhat different from the loan made in 1949, but it was most usual for the year in which it was made.

Mr. Casey: Thank you very much, Mr. Beckett.

(Witness excused.) [39]

Mr. Casey: Your Honor, if I might have 10 days instead of 7——

The Court: Any other evidence?

Mr. Casey: No, I submit my case.

The Court: Any evidence?

Mr. Doll: No, your Honor, we have no evidence to introduce.

The Court: The matter, I take it, being really submitted on the form of these documents, more than anything else?

Mr. Doll: Yes, your Honor.

The Court: Against the background of the rule that you cited, counsel, two circuit decisions, two one way and two the other way.

Mr. Casey: That is right. This is the first time it has been heard in this Circuit.

The Court: And in all four cases the factual situation is similiar? —

Mr. Casey: Similar, yes. There are differences in all four cases as contrasted——

The Court: Are they insurance company cases?

Mr. Casey: Three are insurance company cases, one a bank case. The bank case involved trans-

actions with the same restrictive provisions in the form as we have here. I believe the period was somewhat shorter.

The Court: You say two Circuits decided in favor of the [40] taxpayer and two against him?

Mr. Casey: Yes, your Honor.

The Court: You happen to know what circuits they were?

Mr. Casey: Seven and five were for the taxpayer; the Second Circuit was against the taxpayer, and frankly I have forgotten just what circuit it was, it was also against the taxpayer. The Second Circuit case was the first one that came down, and that was against the taxpayer. It was followed almost immediately by another case that just followed it.

The Court: Certiorari been asked for in any of these cases?

Mr. Casey: Certiorari was asked for by the taxpayer in the first case that came out, the Second Circuit case. Certiorari was denied. That was the first case on this point.

The last case that came up—No, I forget, the next to the last case that came up was in '51. It was for the taxpayer and it was recently announced by the Solicitor General he was not going to seek certiorari in that case.

The Court: He probably is satisfied to try and take his chance on getting some victory without having a final decision by the Supreme Court.

Mr. Casey: I would suspect that is the case, wasn't going to go for certiorari.

The Court: Well, you say you would like to brief this matter?

Mr. Casey: Yes, sir. I would like to have 10 days rather [41] than the 7 I originally asked for. I didn't anticipate we would have this motion to strike pending and that might take a little bit longer.

The Court: I don't think there is very much about the testimony of the witness that would be vital to the case. He has given a general description of the debentures, how they are handled, and it would be most natural to expect that an investment banker would favor that procedure which would most facilitate the business of investment banking so that there wouldn't be the expense to pay. It is purely a legal question, really, isn't it?

Mr. Casey: I would have thought so except for the position that the Treasury took in denying our claim for refund. I don't know whether it was based on misapprehension of some of our facts or what facts they thought regarding the public issuance of security, but certainly did not accept all of our facts.

Mr. Doll: That is not the position taken now by the Government.

The position now is that a debenture should be charged, no ambiguity in it at all, charged simply on its terms and the only way you can administer a revenue measure.

The Court: I would think that probably is so, that we have to decide under this statute whether these particular documents are subject to the stamp

tax, what the congress had in mind in passing this Statute. I think probably it is quite clear that [42] it did not intend to tax these transactions generally regarded as public financing in character, no question about that, and of course, I mean, it didn't intend to tax the ordinary borrowing of money commercially between the borrower and the lender.

Mr. Casey: Yes, your Honor, there was a tax on promissory notes at one time, and it was rescinded and it is no longer in effect.

The Court: It didn't intend to enter the field of general simple borrowing between businessmen and a financial institution or between a businessman and some private person who wanted to lend him some money. Apparently intended not to enter that field, so that I suppose it comes down to a question whether or not this particular type of borrowing, in which a large sum of money is borrowed from financial institutions, such as an insurance company, accompanied by somewhat elaborate arrangements restricting the activities in some respects of the borrower, and it takes it out of the field which Congress didn't intend to enter under this Statute.

I suppose there could be a document that would be a debenture even though there were just one borrower. I mean, just—Yes, if there was just one lender, even if there was one lender, I suppose the document could have all the attributes of what is commonly called debentures.

Mr. Casey: Certainly wouldn't have the same provisions and same terms we do. [43]

The Court: Same general conditions and terms as then would pertain in one of these issues Mr. Beckett spoke about, so that the test probably is not whether or not it is just a single lender, but the test probably is in a general way what Mr. Doll has said as to what the terms and conditions of the transaction are.

Well, could you give me the four Circuit citations now?

Mr. Casey: Yes.

The Court: And I could have a chance to look at them before I receive the briefs; may be helpful in following them.

Mr. Casey: The first one, your Honor, the first one I have here in my notes, Allen vs. Atlanta Metallic Casket Co., 197 Fed. 2d 460.

The Court: Is that for or against the taxpayer?

Mr. Casey: That is for the taxpayer.

The Court: And the other one for the taxpayer?

Mr. Casey: Is Belden Mfg. Co. vs. Ja ki. It is reported at 192 Fed. 2d 211. Also for the taxpayer. That case, your Honor, is the one in which the Solictor General decided not to seek certiorari.

The Court: Ones against the taxpayer?

Mr. Casey: Both of those—No.

The Court: You said those were for.

Mr. Casey: Those were both for.

Mr. Doll: I have them, your Honor. [44]

The Court: Have you got them?

Mr. Doll: General Motors Acceptance Corp. vs. Higgins, 161 Fed. 2d 593. That is in the Second

Circuit. And Commercial Credit Company vs. Hofferburt, 188 Fed. 2d 574. That is in the Fourth Circuit and it affirms 93 Fed. Suppl. 562.

Mr. Casey: The affirmance is merely per curiam, so the opinion is really of the lower Court.

The Court: Opinion of the lower Court. The Government won the first two cases in the Circuit Courts, and then later on the taxpayer won the last two cases, so——

Mr. Doll: I wish to reverse the trend.

The Court: The Courts—197 and 192, must have had the benefit of the contrary decisions.

Mr. Casey: Yes, they are discussed in both opinions.

The Court: Well, you want ten days to file your brief?

Mr. Casey: If I may.

Mr. Doll: Your Honor, I would like to ask for twenty days. I talked to the Department on the phone this morning and they have indicated they would like to write the brief and therefore in order to facilitate that I ask for twenty days.

The Court: And then would like a final ten days to reply?

Mr. Casey: If I may, please.

The Court: All right, then, file briefs in 10, 20.

Mr. Casey: And 10.

The Court: And 10. [45]

The matter may stand submitted on the briefs, then.

Mr. Casey: Yes, your Honor.

Mr. Doll: Thank you, your Honor.

Certificate of Reporter

I, Official Reporter and Official Reporter pro tem, certify that the foregoing transcript of 45 pages is a true and correct transcript of the matter therein contained as reported by me and thereafter reduced to typewriting, to the best of my ability.

/s/ RUSSEL D. NORTON.

[Endorsed]: Filed June 11, 1953. [45-A]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO TRANSCRIPT OF RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing and accompanying documents and exhibits, listed below, are the originals filed in the above-entitled case, and that they constitute the record on appeal as designated by the attorneys for the appellant:

Excerpts from civil docket.
Complaint.
Answer.
Memorandum decision.
Plaintiff's proposed findings of fact and conclusions of law.
Defendant's proposed findings of fact.
Findings of fact and conclusions of law.
Judgment.

Notice of appeal.

Statement of points upon which appellant intends to rely on appeal.

Order extending time to docket appeal and file record.

Designation of record on appeal.

Reporter's transcript for November 24, 1952.

Plaintiff's exhibit 1 to 7.

In Witness Whereof I have hereunto set my hand and affixed the seal of said District Court this 12th day of June, 1953.

[Seal] C. W. CALBREATH,
Clerk.

By /s/ C. M. TAYLOR,
Deputy Clerk.

[Endorsed]: No. 13873. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Leslie Salt Company, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed June 12, 1953.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 13,873

UNITED STATES OF AMERICA,

Appellant,

vs.

LESLIE SALT COMPANY,

Appellee.

STATEMENT OF POINTS UPON WHICH APPELLANT INTENDS TO RELY ON APPEAL

Appellant adopts as points on appeal the statement of points filed with the court below and included in the Transcript of Record on file herein.

LLOYD H. BURKE,
United States Attorney.

/s/ GEORGE A. BLACKSTONE,
Assistant U. S. Attorney,
Attorneys for Appellant.

[Endorsed]: Filed June 18, 1953.

[Title of Court of Appeals and Cause.]

DESIGNATION OF RECORD ON APPEAL

The appellant, upon its appeal from the judgment entered in the above cause on March 2, 1953, desig-

nates the entire record to be printed, together with all original exhibits.

LLOYD H. BURKE,
United States Attorney.

/s/ GEORGE A. BLACKSTONE,
Assistant U. S. Attorney,
Attorneys for Appellant.

[Endorsed]: Filed June 18, 1953.

[Title of Court of Appeals and Cause.]

MOTION FOR PERMISSION TO WAIVE PRINTING OF CERTAIN EXHIBITS

Comes Now the appellant in the above-entitled cause, by its attorney of record and respectfully asks this Court to waive the printing of Exhibits 4 through 6, inclusive, received in evidence in this case, and to permit those original exhibits to be considered and referred to by this Court and by counsel in the same manner as though they were contained in the printed record on appeal.

This motion is made and based upon a stipulation of the parties that is made a part of the record.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General.

/s/ BRUCE M. CASEY, JR.,
Attorneys for Appellee.

So Ordered:

/s/ WILLIAM DENMAN,
Chief Judge.

/s/ WM. E. ORR,
/s/ HOMER T. BONE,
United States Circuit Judges.

[Title of Court of Appeals and Cause.]

STIPULATION NOT TO PRINT CERTAIN EXHIBITS

Comes Now the parties above named by their attorneys of record who agree that inasmuch as Exhibits 4 through 6, inclusive, are duplications of plaintiff's Exhibits 1 through 3, inclusive, except for the names of the lending institutions and the amounts loaned, that Exhibits 4 through 6, inclusive, need not be printed but those exhibits may be considered and referred to by the Court and by counsel in the same manner as though they were contained in the printed record on appeal.

Dated: July 10, 1953.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General;

/s/ BRUCE M. CASEY, JR.,
Attorneys for Appellee.

[Endorsed]: Filed July 13, 1953.

No. 13873

United States
Court of Appeals
for the Ninth Circuit.

UNITED STATES OF AMERICA,

Appellant,

vs.

LESLIE SALT COMPANY,

Appellee.

Supplemental
Transcript of Record

Appeal from the United States District Court for the Northern District of California Southern Division.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—9-11-53

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

PLAINTIFF'S EXHIBIT No. 1

Leslie Salt Co.

3¼% Sinking Fund Promissory Note

Due February 1, 1964

San Francisco, California,
February 1, 1949.

$3,000,000.

Leslie Salt Co., a Delaware corporation (herein called the "Company"), for value received, hereby promises to pay to

The Mutual Life Insurance Company of New York or order, on the first day of February, 1964,

Three Million Dollars

and to pay on August 1 and February 1 in each year interest on the unpaid balance thereof from the date of this Note at the rate of three and one-quarter per cent (3¼%) per annum until the principal hereof shall have become due and payable, and thereafter, if default be made in the payment of such principal, at the rate of six per cent (6%) per annum. Any overdue installment of interest on this Note shall bear interest at the rate of six per cent (6%) per annum to the extent that payment of such interest on overdue interest is enforceable under applicable law. Both the principal hereof and interest hereon are payable at the principal office of The Guaranty Trust Company of New York, in the Borough of Manhattan, The City of New York, in coin or currency of the United States of America

which at the time of payment shall be legal tender for the payment of public and private debts.

This Note is one of one or more Notes (herein called the "Notes"), each of the denomination of $1,000 or a multiple thereof, made or to be made by the Company in an aggregate principal amount of Four Million Dollars ($4,000,000), all of the Notes maturing on February 1, 1964, and bearing interest payable at the same rate and on the same dates as the interest on the principal amount of this Note.

The holder of this Note at his option may surrender the same for exchange at the office of the Company and without expense receive in exchange therefor a Note or Notes in authorized denominations, dated as of the date to which interest has been paid on this Note, and payable to the holder or to such person or persons as may be designated by such holder, or order, for the same aggregate principal amount as the unpaid principal amount of this Note. Every Note made and delivered in exchange for this Note shall in all other respects be in the same form and have the same terms as this Note.

Upon each payment in reduction of the principal of this Note, a notation of the date and amount thereof shall be made hereon, or, at the option of the Company or the holder of this Note, this Note shall be surrendered by the holder at the office of the Company in exchange for a new Note in the principal amount remaining unpaid dated as of the date to which interest has been paid on this Note.

This Note is issued under and is entitled to the

benefits of the provisions of an Agreement of the Company dated February 1, 1949, with respect to the Notes, a copy of such Agreement being on file at the principal office of the Company. As provided in said agreement the Notes may be prepaid prior to maturity at the option of the Company. As further provided in said agreement, the Notes are entitled to the benefits of the sinking fund provided for therein and are subject to prepayment through the operation of such sinking fund. In case an Event of Default, as defined in said agreement, has occurred, the principal of the Notes may be declared or may become due and payable in the manner, at the time, and with the effect provided in said Agreement.

In Witness Whereof, Leslie Salt Co. has caused this Note to be signed in its corporate name by its President or one of its Vice-Presidents and by its Treasurer or an Assistant Treasurer; and this Note to be dated the day and year first above written.

LESLIE SALT CO.,

By .....,

President.

.....,

Treasurer.

[Endorsed]: Filed November 24, 1952.

PLAINTIFF'S EXHIBIT No. 2

Leslie Salt Co.

Certificate of the Company
Pursuant to Agreement Dated February 1, 1949

Leslie Salt Co., a Delaware corporation (herein called the "Company"), in order to induce The Mutual Life Insurance Company of New York to lend to the Company Three Million Dollars ($3,000,000) upon its 3¼% Sinking Fund Note (herein called the "Note"), in like principal amount and in compliance with the agreement between the Company and The Mutual Life Insurance Company of New York dated February 1, 1949 (herein called the "Agreement"), hereby certifies:

1.1. All facts which are represented in the Agreement to exist on the date thereof have continued to exist to the time of delivery of this certificate.

1.2. There has been no material adverse change in the assets or liabilities, or in the condition, financial or otherwise, of the Company from that set forth in its balance sheet as at October 31, 1948.

1.3. The Company owns, with immaterial exceptions, all properties and assets reflected in the balance sheet as at October 31, 1948, except property and assets disposed of in the ordinary course of business, and there are no liens, charges or encumbrances on any of its assets, except as permitted by Paragraph 7.2 of the Agreement.

1.4. There are no actions, suits or proceedings pending or, to the knowledge of the Company

threatened, against or affecting the Company or a Subsidiary, at law or in equity or before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, which in the opinion of the signers could result in any material adverse change in the business, properties or assets or in the condition, financial or otherwise, of the Company and its Subsidiaries.

1.5. Neither the Company nor any Subsidiary is a party to any contract or agreement, or subject to any charter or other corporate restriction, which materially and adversely affects its business, properties or assets, or its condition, financial or otherwise, or conflicts with the provisions of the Agreement.

1.6. Performance of the Agreement and compliance with its terms will not violate any provision of law or of the charter or bylaws of the Company or any Subsidiary and will not conflict with or result in a breach of any of the terms, conditions or provisions of, or constitute a default under, or result in the creation or imposition of any lien, charge or encumbrance upon any of the property or assets of the Company or any Subsidiary pursuant to the terms of, any agreement or instrument to which the Company or any Subsidiary is a party or which it has assumed.

1.7. The Company and its Subsidiaries own, or possess adequate licenses or other rights to use, all trade-marks, trade names, copyrights and patents

necessary to conduct the business of this Company and its Subsidiaries as now operated without known conflict with the asserted rights of others.

1.8. The Company has not, either directly or through any agent, attempted or offered to dispose of the Note, or solicited any offers to buy the Note from, or otherwise approached in connection therewith or negotiated in respect thereof, with, any person or persons other than the two purchasers referred to in the Agreement.

1.9. The business and properties of the Company have not between October 31, 1948, and the date of this Certificate, been materially and adversely affected as the result of any fire, explosion, earthquake, accident, strike, lockout, combination of workmen, priority order of the United States of America or any agency thereof, flood, drought, embargo, confiscation of any plant or of vital materials or inventories by the United States of America or any agency thereof, riot, activities of armed forces, or acts of God or the public enemy.

1.10. The Company is not, upon the execution of the Note, in default in the performance of any of the covenants of the Agreement.

The foregoing representations supersede any previous oral or written statements and are not to be altered or limited by any simultaneous oral or written statement.

In Witness Whereof, Leslie Salt Co. has caused this certificate to be signed in its corporate name

by its President and its corporate seal to be affixed and attested by its Secretary the 15th day of February, 1949.

LESLIE SALT CO.,

[Seal] By FRED B. BAIN,
President.

Attest:

SHELDON ALLEN,
Secretary.

[Endorsed]: Filed November 22, 1952.

PLAINTIFF'S EXHIBIT No. 3

Leslie Salt Co.
310 Sansome Street,
San Francisco, California

February 1, 1949.

The Mutual Life Insurance Company of New York,
34 Nassau Street,
New York 5, N. Y.

Dear Sirs:

Leslie Salt Co., a Delaware corporation (herein called "the "Company"), agrees with you as follows:

Section 1. Sale of Note.

1.1. The Company will authorize the issue of two promissory notes in the aggregate principal amount of Four Million Dollars ($4,000,000), to bear interest at the rate of three and one-quarter

per cent (3¼%) per annum, to be dated February 1, 1949, and to mature February 1, 1964, having terms and provisions substantially as set forth in Exhibit A hereto, with such changes therein, if any, as shall be approved by you and by the Company.

The term "Notes" shall include the aforesaid two notes and each note delivered in substitution therefor; and, where applicable, shall include the singular number as well as the plural. The term "Note" shall mean one of the Notes. The Notes shall be printed and shall be exchangeable and interchangeable as provided therein.

1.2. Subject to the terms and conditions herein set forth, the Company hereby agrees to sell to you and you hereby agree to purchase from the Company on a date (herein called the "closing date") to be fixed by the Company by five (5) days notice in writing to you, not later than February 28, 1949, a Note dated February 1, 1949, in the principal amount of Three Million Dollars ($3,000,000).

1.3. On the closing date, upon delivery to you of such Note you will pay to the Company as the purchase price of such Note an amount equal to one hundred per cent (100%) of the principal amount of such Note, plus an amount equal to interest thereon from the date of such Note to the closing date.

1.4. Delivery of the Note shall be made at the office of the Company, 310 Sansome Street, San Francisco, California, against your payment of the purchase price in current San Francisco funds.

Section 2. Representations.

2.1. The Company has delivered to you:

(1) Balance sheets of the Company as at October 31, 1944, 1945, 1946, 1947 and 1948 and statements of profit and loss and of the surplus accounts for the years ended on said dates, certified by Messrs. McLaren, Goode & Co., Certified Public Accountants, and a balance sheet of the Company as at December 31, 1948, and a statement of profit and loss and of the surplus accounts of the Company for the two months period ended on said date, certified by a financial officer of the Company.

(2) A brief description of the business and properties of the Company.

(3) A list of corporations of which the Company owns substantial percentages of stock, showing the place of incorporation of each and the percentage of stock of each owned by the Company.

All of such statements have been marked "Exhibit B to Agreement dated February 1, 1949."

The Company represents that:

2.2. Such financial statements so delivered are correct and complete and fairly present, respectively, the financial condition of the Company as at the dates specified therein and the results of its operations for the respective periods specified therein.

2.3. The above-mentioned balance sheet of the Company as at December 31, 1948, reflects all liabilities, contingent or otherwise, of the Company at such date, except liabilities which are not required to be so reflected in accordance with sound account-

ing practice. Such liabilities not so reflected were incurred in the ordinary course of business and do not in the aggregate have any material adverse effect upon the position of the Company.

2.4. The above-mentioned financial statements have been prepared in accordance with sound accounting practice, consistently maintained throughout the periods involved except as otherwise specifically indicated therein.

2.5. The net earnings of the Company available for fixed charges for the period of five fiscal years ended October 31, 1948, have averaged per year not less than one and one-half times its average annual fixed charges applicable to such period and during the fiscal year ended October 31, 1948, such net earnings available for fixed charges were not less than one and one-half times its fixed charges for such year. As used in this sub-paragraph the terms "net earnings available for fixed charges" and "fixed charges" have the meanings assigned to them in Section 81 (2) of the New York Insurance Law.

Section 3. Conditions of Purchase.

Your obligation to purchase and pay for the Note shall be subject to the conditions set forth in the following Paragraphs 3.1 to 3.5, inclusive:

3.1. The Company shall deliver to you at the closing of the sale of the Note, a Certificate of the Company, duly authorized, executed and delivered by the Company, substantially in the form of the Certificate annexed hereto, marked Exhibit C, the truth and accuracy of which, at the time of closing,

shall be conditions precedent to your obligations hereunder.

3.2. You shall have received from Messrs. Barton, McNaughton, Douglas & Leiby, your special counsel in connection with this transaction, and from Messrs. Chickering & Gregory, counsel for the Company, their opinions in form and substance satisfactory to you that—

(i) The Company is a duly organized and validly existing corporation, in good standing under the laws of its state of incorporation and having the corporate power to conduct its business.

(ii) This agreement has been duly authorized by the Company and duly executed and delivered by an authorized officer of the Company and constitutes a valid and legally binding obligation of the Company, enforceable in accordance with its terms.

(iii) The Note has been duly authorized by the Company and duly executed and delivered by authorized officers of the Company and is a valid and legally binding obligation, enforceable in accordance with its terms.

(iv) The Certificate of the Company delivered by the Company pursuant to Paragraph 3.1 of this Agreement has been duly authorized, executed and delivered by authorized officers of the Company, and such certificate is an instrument binding upon the Company, entitling you to remedies provided by law against the Company in case of any material misrepresentations therein.

(v) The permission and consent required of the Corporation Commission of the State of California

to the issuance and sale of the Note have been duly and regularly obtained. No other authorization of governmental authority is required for the issuance and sale of the Note.

(vi) The offering, issue and delivery of the Notes, under the circumstances contemplated by this Agreement, constitute an exempted transaction under the Securities Act of 1933, as amended, and do not require registration of the Notes thereunder; it is not necessary in connection therewith to qualify an indenture in respect thereof under the Trust Indenture Act of 1939; and since you are acquiring the Note for investment and not with a view to distribution, if you should in the future deem it expedient to sell the Note or any of the New Notes (which you do not now contemplate or foresee), such sale would be an exempted transaction under the Securities Act of 1933, as amended, and would not of itself require registration of the Note or the New Notes thereunder, although such registration would be required as a condition of any distribution by underwriters, as defined in said Act, if at the time of sale you control the Company.

3.3. You shall receive from said Messrs. Chickering & Gregory, counsel for the Company, their further opinion in form and substance satisfactory to you that (i) the Subsidiaries are duly organized and validly existing corporations, in good standing under the laws of their respective places of incorporation, (ii) the Company owns all shares of stock referred to in Exhibit B hereto as owned by the Company and such shares are validly issued, fully

paid and non-assessable, (iii) the Company is duly qualified to do business in California and (iv) (with possible exceptions of no materjal importance) the title of the Company to its properties and assets is as represented in Clause 1.3 of the form of Certificate of the Company annexed hereto marked Exhibit C. In rendering the opinion required by the foregoing Clause (i), counsel for the Company may rely upon the opinions of local counsel; in rendering the opinion required by the foregoing Clause (ii), counsel for the Company may rely upon the opinions of local counsel insofar as such opinion relates to the shares being validly issued, fully paid and non-assessable; and in rendering the opinion required by the foregoing Clause (iii), said counsel may rely on policies of title insurance issued by reputable companies and, as to matters not of public record, upon certificates of officers of the Company as to relevant facts.

3.4. The Company shall have entered into a separate agreement with another investor (who shall have represented to the Company that it is purchasing the Note for its own account, for investment, and not with a present view of the distribution thereof), with reference to the sale of the balance of the Four Million Dollars ($4,000,000) principal amount of the Notes, and shall have sold such Note to such other investor concurrently with the closing hereunder.

3.5. All proceedings to be taken in connection with the transactions contemplated by this Agree-

ment and all documents incident thereto, shall be satisfactory in form and substance to you and your special counsel; and you shall receive copies of all documents which you may reasonably request in connection with said transactions and all corporate proceedings in connection therewith in form and substance satisfactory to you and your special counsel.

Section 4. Purchase for Investment; New Indenture.

4.1. This Agreement is made by the Company in reliance upon your representation that you are acquiring the Note to be issued to you hereunder for your own account, and not with a view to, or for sale in connection with, the distribution thereof; and that you have no present intention of selling or distributing said Note, it being understood, however, that the disposition of your property shall at all times be within your control.

4.2. The Company agrees that so long as you hold one or more of the Notes and the aggregate principal amount of the Note or Notes held by you is Three Hundred Thousand Dollars ($300,000) or more, the Company will as soon as reasonably possible after the receipt of a written request from you, execute and deliver at the expense of the Company, a trust indenture (hereinafter called the "New Indenture") providing for the issue thereunder of 3¼% Sinking Fund Notes of the Company due February 1, 1964 (herein called the "New Notes"), limited to the principal amount of the Notes unpaid

at the date of execution of the New Indenture, bearing interest at the rate and entitled to the substantive benefits of the Notes. The New Notes shall be issuable (except in case of destroyed, lost or stolen New Notes and in case of exchanges, interchanges, transfers, reissues, etc., of New Notes) only against surrender of the Notes. The New Indenture shall be delivered to a bank or trust company selected by the Company having a combined capital and surplus of not less than Three Million Dollars ($3,000,000) in good standing and having its principal office in the Borough of Manhattan, The City of New York, or in San Francisco, California, which is authorized by law to exercise corporate trust powers and is subject to supervision or examination by federal or state authority.

The New Indenture shall be substantially as set forth in Exhibit D hereto.

4.3. After the execution of the New Indenture, upon surrender of a Note or Notes by you, the Company will deliver without charge to you, in exchange therefor, New Notes in an aggregate principal amount equal to the unpaid principal amount of the Note or Notes so surrendered, and of the same or a different authorized denomination or denominations (One Thousand Dollars [$1,000] or a multiple thereof) and either in registered form without coupons or in coupon form, and in printed or in fully engraved form, all as you may elect, and bearing interest from the date to which interest shall have been paid on the Note or Notes so sur-

rendered, all such New Notes delivered to you to be duly authorized, executed and delivered by the Company and valid and outstanding obligations of the Company, entitled to the benefits of the New Indenture in accordance with its and their terms and complying with the provisions of this Agreement, in the opinion of your counsel.

The Company will bear all expenses in connection with the preparation, execution and delivery of the New Indenture and the preparation, issue and delivery to you at your home office (including payment of all stamp and other taxes, except any tax on any transfer thereof) of any New Notes.

Section 5. Sinking Fund and Prepayment Provisions. Fixed Sinking Fund Payments.

5.1. On February 1, 1951, and thereafter annually on February 1 in each year to and including February 1, 1963, the Company will call for prepayment and prepay, without premium, a principal amount of the Notes equal to Two Hundred Eighty-five Thousand Dollars ($285,000), such prepayments being herein called "Fixed Sinking Fund Payments," and the dates upon which such payments are to be made being herein called "Fixed Sinking Fund Payment Dates." Prepayments made pursuant to other provisions of the Agreement shall not be deemed to anticipate Fixed Sinking Fund Payments.

Optional Sinking Fund Payments

5.2. On each Fixed Sinking Fund Payment Date, the Company, at its option, may call for prepay-

ment, on notice given as provided in Paragraph 5.3, and prepay, without premium, a further principal amount of the Notes equal to Two Hundred Eighty-five Thousand Dollars ($285,000), provided that the cash to be disbursed in connection with such prepayment represents the proceeds of earnings or of the liquidation of assets and neither has been nor will be raised or reimbursed to the Company directly or indirectly from other sources. If the Company shall not exercise any such option on any Fixed Sinking Fund Payment Date, such option shall lapse as to such date and may not be exercised at any time thereafter.

Optional Prepayments; Notice of Prepayment

5.3. At the option of the Company, upon giving written notice to the holders of the Notes to be prepaid not less than thirty (30) days nor more than sixty (60) days prior to the date fixed for prepayment, the entire principal amount of the Notes then outstanding may be called for prepayment and prepaid on any date, or any part thereof not less than Fifty Thousand Dollars ($50,000) may be called for prepayment and prepaid from time to time on any date, upon payment of the principal amount to be prepaid, together with unpaid interest accrued thereon to the date fixed for prepayment and a premium equal to the following respective percentages of the principal amount being prepaid:

If prepaid in the twelve months period ending January 31—	Premium
1950	3%
1951	3%
1952	3%
1953	2¾%
1954	2½%
1955	2¼%
1956	2%
1957	1¾%
1958	1½%
1959	1¼%
1960	1%
1961	¾%
1962	½%
1963	¼%
1964	None

5.4. Notice of call for prepayment having been given pursuant to Paragraph 5.3, the principal amount to be prepaid shall on the date designated in such notice become due and payable, with the applicable premium, if any, and interest.

Notation of Prepayment

5.5. Upon each payment in reduction of the principal of any Note, a notation of the date and amount thereof shall be made thereon, or, at the option of the Company or the holder of such Note, such Note shall be surrended by the holder at the office of the Company in exchange for a new Note in the principal amount remaining unpaid dated

as of the date to which interest has been paid on such Note.

Allocation of Prepayments

5.6. If payments are made under Paragraphs 5.1, 5.2 or 5.3 or if other payments of less than the entire principal amount of all Notes outstanding are made at any time, the Company will allocate the principal amount prepaid, in multiples of One Thousand Dollars ($1,000), among the several holders, if more than one, in proportion to the principal amounts then held by them respectively.

Notes Not to Be Reissued

5.7. To the extent that Notes are prepaid, in whole or in part, the portion so paid shall be cancelled, and no new Notes shall be reissued in respect of the amount so prepaid.

Section 6. General Covenants of the Company.

The Company represents, covenants and agrees that, from the date hereof and so long as you or your successors and assigns shall hold any of the Notes:

Payment of Taxes

6.1. The Company and its Subsidiaries (the term "Subsidiary" and various other terms used herein being defined in Paragraphs 8.1, et seq.) will promptly pay and discharge all lawful taxes, assessments and governmental charges or levies imposed upon them respectively or upon their respective incomes or profits, or upon any property, real, personal or mixed, belonging to them respectively; provided, however, that neither the Company nor

any Subsidiary shall be required to pay any such tax, assessment, charge, or levy, if the same shall not at the time be due and payable or can be paid thereafter without penalty or if the validity thereof shall currently be contested in good faith by appropriate proceedings and if the Company or such Subsidiary, as the case may be, shall have set aside on its books reserves deemed by it adequate with respect to any such tax, assessment, charge or levy.

Maintenance of Properties and Corporate Existence

6.2. The Company and its Subsidiaries will keep their respective properties in good repair, working order and condition, and from time to time will make all needed and proper repairs, renewals, replacements, extensions, additions, betterments and improvements thereto, so that the business carried on by the Company and its Subsidiaries may be properly and advantageously conducted at all times in accordance with prudent business management.

The Company will, subject to the provisions hereof, maintain its corporate existence.

Books of Account

6.3. The Company and each Subsidiary will keep books of record and account in which full, true and correct entries will be made of all dealings or transactions in relation to their respective businesses and activities in accordance with sound accounting practice.

Accruals, Reserves

6.4. For the purposes of this Agreement, the Company and its Subsidiaries will reflect in their

respective applicable financial statements during any period, using estimates (subject to adjustment) if necessary as to periods less than a fiscal year:

(1) Appropriations to reserves for depreciation, depletion, obsolescence and/or amortization in an amount not substantially less than the amount accrued in accordance with sound accounting practice, claimed for such period by the Company or such Subsidiary, as the case may be, for Federal income tax purposes (subject to adjustment in respect of any part of such amount claimed but not allowed).

(2) Accruals in accordance with sound accounting practice for Federal and all other taxes for such period, including all taxes based on or measured by income or profits.

(3) All other appropriations to reserves which should be made in accordance with sound accounting practice in connection with the business conducted by the Company or such Subsidiary.

Insurance

6.5. The Company and each Subsidiary will keep all of their respective plants and properties and inventories which are of an insurable character insured by financially sound and reputable insurance companies or associations, against loss or damage by fire or explosion, in amounts sufficient to prevent the Company or such Subsidiary from becoming a co-insurer within the terms of the insurance policies covering such risks, and in any event in amounts not less than eighty per cent (80%) of the insurable value of the property insured. The

Company and each Subsidiary will also maintain insurance with such insurance companies and associations (or with a state-operated fund) against loss or damage from other hazards and risks to their properties, to the property of others and to the person, of the character and in amounts usually maintained by companies engaged in the same or a similar business similarly situated.

Financial Statements

6.6. Within ninety (90) days after the end of each fiscal year and within forty-five (45) days after the end of each first quarter-annual period, each first semi-annual period, and each third quarter-annual period (beginning with the period ending January 31, 1949), the Company will deliver to each holder of ten per cent (10%) or more in principal amount of the Notes, the following financial statements, in reasonable detail: (a) a balance sheet of the Company as at such date, (b) a statement of income for such period ended on such date, (c) an analysis of the surplus account for such period, (d) an analysis of Stock Payments made during such period and (e) a copy of the detailed reports, if any, submitted by independent accountants in connection with such of the financial statements as have been certified by independent accountants.

The Company will also deliver to each such holder of the Notes within ninety (90) days after the end of each fiscal year a balance sheet of each Subsidiary as at such date, a statement of the income

of each Subsidiary for such fiscal year and an analysis of the surplus account of each Subsidiary for such fiscal year.

The financial statements with respect to fiscal years shall be certified by an independent public accountant of recognized standing, or a firm of independent public accountants of recognized standing. Such accountant or firm of accountants shall be selected by the Company and approved by each holder of twenty per cent (20%) or more in principal amount of the Notes, if there be one or more such holders of Notes. The financial statements with respect to the first and third quarter-annual periods and the first semi-annual period in each year need not be audited but shall be certified by the Treasurer or an Assistant Treasurer of the Company.

If the Company shall at any time change its fiscal year the interim period, if less than a full quarter-annual period, shall be treated as a quarter-annual period.

Compliance Certificates

6.7. Concurrently with the delivery of financial statements with respect to each fiscal year, the Company will deliver to each holder of ten per cent (10%) or more in principal amount of the Notes a written statement of the independent public accountant or firm of independent public accountants which shall have certified such financial statements, to the effect that in making the audit necessary to said certification, they have obtained no knowledge

of any default hereunder, except as specifically indicated.

6.8. Concurrently with each delivery of financial statements with respect to each fiscal year, the Company will deliver to each holder of ten per cent (10%) or more in principal amount of the Notes a Certificate of the President or a Vice-President of the Company stating that, to the best of his knowledge, except as specifically indicated, the Company is not in default in its obligations hereunder.

Section 7. Particular Covenants of the Company. From the date hereof and so long as you or your successors and assigns shall hold any of the Notes:

Liabilities

7.1. Neither the Company nor any Subsidiary will create, assume, incur or in any other manner become or remain liable in respect of or suffer to continue in existence, any Indebtedness other than Indebtedness described in one or more of the following Clauses (1) to (6), inclusive:

(1) The Notes and any New Notes issued pursuant to Paragraphs 4.2 and 4.3 in exchange for Notes.

(2) Unsecured Current Liabilities of the Company or a Subsidiary, not more than six months overdue unless contested in good faith, provided that:

(a) The Company shall not incur any liability for money borrowed pursuant to this Clause (2)

except for loans from commercial banks incurred in the ordinary course of the business of the Company.

(b) No Subsidiary shall incur any liability for money borrowed except as expressly permitted by Clauses (3) and (4) hereof.

(3) Purchase Money Obligations of the Company or a Subsidiary permitted by Clause (4) of Subdivision A of Paragraph 7.2, not overdue, in an aggregate amount not exceeding Two Hundred Fifty Thousand Dollars ($250,000) at any one time outstanding of the Company and all Subsidiaries.

(4) Indebtedness of a Subsidiary to the Company.

(5) Current Liabilities of the Company or a Subsidiary for taxes, assessments, governmental charges or levies to the extent that payment thereof shall not at the time be required to be made in accordance with the provisions of Paragraph 6.1.

(6) Current Liabilities of the Company or a Subsidiary in respect of judgment or awards, or which are the subject of attachment, to the extent that payment thereof shall not at the time be required to be made in accordance with the provisions of Clause (2) of Subdivision A of Paragraph 7.2.

Salter Machine Co. will not create, assume, incur or in any other manner become or remain liable in respect of or suffer to continue in existence any Indebtedness for money borrowed from persons other than the Company in excess of an aggregate amount of Fifteen Thousand Dollars ($15,000) at any time outstanding, exclusive of moneys borrowed

which are to be repaid solely from rentals paid by lessees of the machines of Salter Machine Co. in connection with bona fide leases thereof made by said company.

Liens, Priority Claims, Certain Transfers

7.2. Neither the Company nor any Subsidiary will:

Create or permit to continue in existence any mortgage, pledge, encumbrance, lien or charge of any kind upon any of its property or assets, whether owned at the date hereof or hereafter acquired; or

Transfer any of such property or assets if in connection with such transfer the same will be subjected to the payment of obligations of the Company or a Subsidiary (including without limitation obligations to pay installments upon purchase contracts or to pay rent, whether or not deemed Indebtedness); or

Transfer any of its notes receivable or accounts receivable with recourse; or

Acquire or agree to acquire any property or assets upon conditional sales agreement, lease-purchase agreement or other title retention agreement; or

Suffer to exist for a period of more than thirty (30) days after the same shall have been incurred any indebtedness or liability of, or claims or demands against, the Company or such Subsidiary which, if unpaid, might (in the hands of the holder or any one, including the United States of America, who shall have guaranteed the same or who has any right or obligation to purchase the same) by law

or upon bankruptcy or insolvency, or otherwise, be given any priority whatsoever over its general creditors,

except that:

A. The Company or any Subsidiary may create, incur, suffer to be created or incurred or to exist—

(1) Liens, charges, encumbrances and priority claims which (a) are incidental to the conduct of its business or the ownership of its properties and assets, which (b) were not incurred in connection with the borrowing of money or the obtaining of advances or credit, and which (c) do not in the aggregate materially detract from the value of its property or materially impair the use thereof in the operation of its business.

(2) Liens in respect of judgments or awards, provided that the same are discharged within sixty (60) days after entry, or as to which the Company or such Subsidiary at the time shall in good faith be prosecuting an appeal or proceedings for review and as to which the Company or such Subsidiary shall have secured a stay of execution pending such appeal or proceedings for review, and liens in respect of attachments which are discharged within sixty (60) days after entry, or which shall have been bonded and as to which the Company or such Subsidiary at the time shall in good faith be conducting proceedings.

(3) Liens and/or priority claims for taxes or assessments or governmental charges or levies if payment of the same shall not at the time be re-

quired to be made in accordance with the provisions of Paragraph 6.1.

(4) Liens upon, or conditional sales agreements, lease-purchase agreements or other title retention agreements affecting, real estate, machinery or equipment purchased after February 1, 1949, securing the payment of a portion of the purchase price of such real estate, machinery or equipment or existing on such real estate, machinery or equipment at the time of acquisition thereof, or extensions or renewals or refundings thereof, provided that—

(a) The Indebtedness secured by such lien, conditional sales agreement, lease-purchase agreement or title retention agreement (herein called "Purchase Money Obligations") shall not exceed sixty-six and two-thirds per cent (66⅔%) of the cost of the property subject thereto (or the fair value thereof to the Company or such Subsidiary at date of acquisition, if less than cost) to the Company or such Subsidiary.

(b) Every such lien shall be expressly limited to the property subject thereto and, in the case of real property, fixed improvements erected or to be erected thereon.

(c) The Purchase Money Obligation in question shall be permitted by Clause (3) of Paragraph 7.1.

B. A Subsidiary may mortgage or pledge or otherwise encumber all or any part of its assets to secure any obligation owing to the Company.

C. The Company or any Subsidiary may in the ordinary course of business endorse or deposit for collection or sell without recourse notes receivable, accounts receivable, drafts and trade acceptances.

Dividends, Purchase of Stock, etc.

7.3. The Company will not—

Declare any dividends on any of its stock;

Directly or indirectly or through any Subsidiary purchase, or redeem or retire or give notice of redemption or retirement of, any of the stock of the Company; or

Make any other distribution in cash or property to the holders of its stock;

(such declarations of dividends, purchases, redemptions, retirements, distributions [excluding, however, any such which may be payable solely in common stock of the Company] being herein collectively called "Stock Payments"), except as follows:

(1) The Company may make Stock Payments if and to the extent that, after giving effect thereto, the Amount of all Stock Payments for the period subsequent to October 31, 1948, taken as one accounting period, will not be greater than the excess if any of

(a) The sum of (i) the Net Income of the Company for such period subsequent to October 31, 1948, plus (ii) Five Hundred Thousand Dollars ($500,000), over

(b) An amount equal to Twenty Thousand Eight Hundred Thirty-three Dollars ($20,833) multiplied by the number of full calendar months elapsed from November 1, 1948, to the earliest of (i) the end of the calendar month next preceding the date of such Stock Payment, (ii) November 1, 1956, or (iii) the end of the calendar month in

which the aggregate principal amount of the Notes is reduced to Two Million Dollars ($2,000,000).

(2) The Company may declare and pay dividends payable solely in common stock of the Company or make other distributions to holders of stock of the Company if such distributions are made solely in common stock of the Company and may make exchanges of common stock of the Company for other stock of the Company or may acquire stock of the Company out of the proceeds of the substantially concurrent sale of other shares of its common stock.

The Company will not declare any dividend payable more than ninety (90) days after the date of declaration thereof.

The Company will not become or be liable under any agreement to purchase stock of the Company if such purchase would be prohibited by the provisions of this Paragraph 7.3.

The Company may credit against Stock Payments of the character of purchases, redemptions and retirements of stock of the Company the net consideration, in cash or property (other than stock of the Company), received upon the sale subsequent to October 31, 1948, of common stock of any class of the Company.

Net Working Capital

7.4. The Net Working Capital of the Company will at all times be not less than One Million Dollars ($1,000,000).

Guarantees

7.5. Neither the Company nor any Subsidiary will guarantee or otherwise become secondarily liable for the payment by any other person of any debt, liability or dividend or for the value of any security nor permit any such secondary liability to continue in existence, except

(1) Endorsements for deposit in the ordinary course of business.

(2) Other secondary liability aggregating not in excess of Twenty-five Thousand Dollars ($25,000) at any time outstanding of the Company and all Subsidiaries.

Investments, Loans, Advances

7.6. Neither the Company nor any Subsidiary will acquire or hold any stock of, or make or have any other investment in any securities of, or make or have outstanding any loan or advance to, any person, except as permitted by one or more of the following Clauses (1), (2), (3) and (4):

(1) The Company may acquire and hold stock of, and make and have other investments in securities of, and make and have outstanding loans and advances to, (a) Subsidiaries existing as such on February 1, 1949, without limit as to amount, (b) one or more Wholly-owned Subsidiaries, without limit as to amount, and (c) Salter Machine Co., in an aggregate amount not exceeding Fifty Thousand Dollars ($50,000), exclusive of expenditures to acquire stock of said Company outstanding December 31, 1948.

(2) The Company and any Subsidiary may acquire and hold direct obligations of the United States of America without limit as to amount.

(3) The Company and any Subsidiary may acquire and hold its own stock or other of its own securities.

(4) The Company and Subsidiaries may acquire and hold stock of, and make and have other investments in securities of, and make and have outstanding loans and advances to, other persons, provided that the aggregate investment at any one time outstanding pursuant to this Clause (4) shall not exceed Fifty Thousand Dollars ($50,000).

Issue of Stock of Subsidiaries, Consolidation, Merger, etc., of Subsidiaries

7.7. No Subsidiary will:—

A. Issue or dispose of any of its stock or other securities to any person other than the Company except to the extent, if any, that common stock may be issued to minority stockholders as their pro rata share of additional issues of stock.

B. Sell, lease, transfer or otherwise dispose of, except in the ordinary course of business, any substantial part of its assets to any person other than the Company or (except in connection with mergers or consolidations permitted by Paragraph 7.9) consolidate with or merge into any person, or permit any person to merge into it.

Partial Disposition of Subsidiaries

7.8. Neither the Company nor any Subsidiary will sell, assign, transfer, dispose of, or in any way

part with the control of, any shares of stock of, or indebtedness owed to the Company or any Subsidiary by, any Subsidiary, except to the Company or a Wholly-owned Subsidiary, unless simultaneously therewith all such shares of stock and indebtedness (except indebtedness incurred in the ordinary course of business) of such Subsidiary at the time owned by the Company and all Subsidiaries shall be sold as an entirety to a person other than an affiliate for a consideration in cash which, in the opinion of the Board of Directors of the Company evidenced by a resolution thereof, represents the fair value at the time of sale of the shares and indebtedness so sold, provided that such sale will not materially and adversely affect the conduct of the business of the Company and its other Subsidiaries nor be disadvantageous in any material respect to the holders of the Notes.

Consolidation, Merger, etc.

7.9. The Company will not sell, transfer or otherwise dispose of any substantial part of its assets except in the ordinary course of business, and will not consolidate with, or merge into, any person, except a Wholly-owned Subsidiary or permit any other person (except a Wholly-owned Subsidiary) to merge into the Company, and no such consolidation with or merger into, any such Wholly-owned Subsidiary shall be effected unless such Wholly-owned Subsidiary (if it be the successor corporation) shall expressly assume the obligations of the Company under this Agreement and the Notes and

unless after giving effect thereto, no default shall exist in the performance of any of the covenants, conditions or agreements of this Agreement and the Notes.

For the purposes of Paragraph 7.7 and this Paragraph 7.9 assets shall be deemed to be a substantial part of the assets of the Company or a Subsidiary if the book value thereof after depreciation, when added to the book value after depreciation (at the time of disposition) of all other assets disposed of since February 1, 1949, not in the ordinary course of business, by the Company or such Subsidiary, as the case may be, would exceed ten per cent (10%) of the book value after depreciation of all of the assets of the Company or such Subsidiary, as the case may be, at the time of the proposed disposition.

Leases

7.10. Neither the Company nor any Subsidiary will become or be liable as lessee under any lease of real or personal property having a term of more than three years or as vendee in possession under any contract to purchase real or personal property, having a term greater than one year, if, thereafter, the aggregate amount of rental and installments of purchase price accrued and to accrue, required to be paid by the Company and its Subsidiaries under all such leases having a term of more than three years, and under all such contracts having a term greater than one year, will be in excess of Twenty-five Thousand Dollars ($25,000) in any period of twelve consecutive months, exclusive of any rental

and installments of purchase price payable under leases and contracts incurred pursuant to Clause (4) of Subdivision A of Paragraph 7.2 and exclusive of rentals of office space or office equipment.

Change of Business

7.11. The Company will not change the general character of its business.

Waiver

7.12. Upon the written consent of the holders for the time being of at least eighty per cent (80%) of the principal amount of the Notes at the time outstanding (i) compliance with any of the covenants and conditions set forth in Paragraphs 6.1 to 7.11, inclusive, may be waived and (ii) changes and modifications in the provisions of Paragraphs 6.1 to 8.14 (except this Paragraph 7.12) may be made.

Section 8. Definitions.

For the purposes of this Agreement and any certificates delivered pursuant to this Agreement:

8.1. "Company" shall mean Leslie Salt Co., a Delaware corporation, and its successors.

8.2. "Person" shall mean an individual, a corporation, a partnership, a trust or unincorporated organization, or a government or political subdivision thereof.

8.3. "Subsidiary" shall mean any corporation more than fifty per cent (50%) of the issued and outstanding stock of which having ordinary voting power (other than stock which has acquired such power only by reason of the happening of a con-

tingency) shall at the time be owned or controlled, directly or through any intervening medium, by the Company.

"Wholly-owned Subsidiary" of a corporation shall mean a Subsidiary all of the issued and outstanding stock of which (except directors' qualifying shares) shall at the time be owned by such corporation.

8.4. "Indebtedness" of any person shall include all obligations of such person which in accordance with sound accounting practice shall be classified upon a balance sheet of such person as liabilities of such person, and in any event shall include all indebtedness, debt and other similar monetary obligations of such person, whether direct or guaranteed.

"Indebtedness" shall also include (a) all Indebtedness secured by mortgage, pledge, lien, charge or encumbrance on assets owned by such person, whether or not such Indebtedness actually shall have been created, assumed or incurred by such person and (b) all obligations under agreements to pay installments of purchase price or other like payments with respect to fixed assets in possession of the purchaser, including obligations ostensibly to pay rent under which such person is to acquire an equity in the rented property.

In computing the amount of Indebtedness at any date, there shall be included an amount equal to all reserves at such date in respect of debts and other similar monetary obligations of such person, either direct or guaranteed.

8.5. "Current Liabilities" of any person shall include, at any date as of which the amount thereof shall be determined, all Indebtedness of such person which would, in accordance with sound accounting practice, be classified as current liabilities, in any event including

(1) All Indebtedness of such person payable on demand or maturing not more than one year after such date, including all serial maturity and fixed sinking fund payments.

(2) Reserves, adequate in the opinion of such person, in respect of contingent or disputed obligations which do not mature by their terms more than one year after such date, excluding, however, any reserves which are in effect mere subdivisions of surplus or offsets to asset values.

(3) All Indebtedness of such person due to a Subsidiary thereof, regardless of maturity date.

(4) Accruals for Federal and other taxes based on or measured by income or profits, provided that there may be offset against Federal taxes, tax savings notes issued by the United States of America, at principal amount plus accrued interest.

8.6. "Funded Debt" of any person shall include at any date as of which the amount thereof is to be determined, all Indebtedness of such person not included or provided for within the foregoing definition of Current Liabilities at such date.

8.7. "Current Assets" of any person shall include all assets of such person which in accordance with sound accounting practice shall be so classified, all after deduction of all reserves properly de-

ductible from such assets in accordance with sound accounting practice; and may include readily marketable securities issued by the government of the United States of America taken at a value not in excess of the current market value, but shall not include any of the following:

(1) Stocks, bonds or other like securities, except as aforesaid.

(2) Indebtedness owed to such first mentioned person by any other person, more than twenty-five per cent (25%) of the stock of any class of which is owned by such person, except to the extent that such Indebtedness arose in connection with the sale of merchandise, the performance of services or the rental of property in the ordinary course of business.

(3) Patents, patent applications, trade-marks, copyrights, trade names, good will, deferred expenses, unamortized debt discount and expense, or other like intangibles.

(4) Prepayments of interest and insurance.

8.8. "Net Working Capital" of any person shall mean the excess of the Current Assets of such person over the Current Liabilities of such person.

8.9. "Net Income" of any person for any period shall be determined by deducting from the amount of the gross income of such person for such period, all operating expenses and other proper deductions from income for such period, including (without limiting the generality of the foregoing) interest on all outstanding indebtedness, amortization of debt discount and expense, amortization of all other

deferred items properly subject to amortization, provision for all taxes, including income taxes, provisions for all contingency reserves, whether general or special, and provisions for depreciation and obsolescence in amounts not less than those actually deducted on the books of such person and not less than as required by the provisions of Clause (1) of Paragraph 6.4, provided, however, that

(1) Profits realized or losses sustained from the sale or other disposition of major items of capital assets or from the acquisition or retirement or sale of securities of such person or any Subsidiary of such person shall not be included.

(2) The Net Income of the Company for any fiscal year shall reflect as income or as a deduction from income, as the case may be, any adjustment (whether made through income or surplus accounts) which, although not attributable to such fiscal year, would be required to be made to compute Net Income of the Company for the period from October 31, 1948, through such fiscal year, and may reflect any restoration of any contingency reserve established after October 31, 1948, but shall not include material adjustments in respect of a period prior to, or mere reversals of reserves existing on, October 31, 1948.

(3) Dividends of Subsidiaries shall not be included unless paid from earned surplus arising since October 31, 1948.

8.10. "Stock Payment" shall have the meaning specified in Paragraph 7.3. The term "Amount" when used with reference to a Stock Payment, shall

mean the amount of cash paid or to be paid, and the net book value or the fair value, whichever is greater, at the time of distribution, of property distributed or to be distributed in respect of such Stock Payment.

8.11. Subject to the provisions of Paragraphs 8.1 to 8.10, inclusive, all computations to be made pursuant to this Agreement shall be made, and all financial statements shall be prepared, in accordance with sound accounting practice.

8.12. Whenever any computation to be made pursuant to this Agreement, is directed to be made "in accordance with sound accounting practice," such computation shall be made in accordance with sound accounting practice current at the time of such computation.

Section 9. Events of Default.

9.1. If one or more of the following events, herein called "Events of Default," shall happen and be continuing, the principal of the Notes with the premium thereon, if any, and accrued unpaid interest thereon shall upon demand of the holder of any of the Notes (if not already due and payable) become due and payable forthwith:

(1) Default be made in the punctual payment of any principal amount due under any of the Notes, when and as the same shall become due and payable.

(2) Default be made in the payment of any installment of interest on any of the Notes, and such default shall continue for thirty (30) days.

(3) Default be made in the due observance or performance of any covenant contained in Paragraphs 7.1 to 7.10, inclusive, of this Agreement;

(4) Default be made in the due observance or performance of any covenant contained in any Paragraph of this Agreement other than Paragraphs 7.1 to 7.10, inclusive, and such default shall continue for thirty (30) days after written notice thereof shall have been given to the Company by a holder of a Note.

(5) Final judgment for the payment of money which, with one or more other outstanding judgments, exceeds Fifty Thousand Dollars ($50,000) in aggregate amount, shall be rendered against the Company and the same shall not be discharged, or provision made for the discharge thereof in accordance with its terms within sixty (60) days from the entry thereof, or an appeal therefrom or other appropriate proceeding for the appellate review thereof, shall not be taken within said period and a stay of execution pending such appeal shall not be secured or if such appeal be taken and on such appeal the same shall be affirmed and the Company shall not discharge said judgment within sixty (60) days after the entry of the order or decree of affirmance.

(6) Either a petition shall be filed voluntarily, or filed and consented to, or filed and not dismissed within sixty (60) days (exclusive of any period during which a stay shall be in effect), seeking an order of the character mentioned below, or such an order shall be made by a court of competent juris-

diction and be in effect for sixty (60) days from the date of entry thereof:

(a) An order adjudicating the Company or a Subsidiary having assets of a net book value of Two Hundred Fifty Thousand Dollars ($250,000) or more (such a Subsidiary being hereinafter called a "Principal Subsidiary") a bankrupt, or

(b) An order appointing a trustee or receiver of the Company or a Principal Subsidiary or of any substantial part of their respective properties, or

(c) An order approving a petition for an arrangement in bankruptcy, a reorganization pursuant to the Federal Bankruptcy Act or any other judicial modification or alteration of the rights of the holders of the Notes or of other creditors of the Company or a Principal Subsidiary, or

(d) An order effecting such an arrangement, reorganization, modification or alteration, or

the Company or a Principal Subsidiary shall make an assignment for the benefit of its creditors.

Section 10. Miscellaneous.

10.1. To the extent permitted by applicable law, the Company hereby agrees to waive, and does hereby absolutely and irrevocably waive and relinquish the benefit and advantage of any valuation, stay, appraisement, extension or redemption laws now existing or which may hereafter exist, which, but for this provision, might be applicable to any sale made under the judgment, order or decree of any court, or otherwise, based on any Note or on any claim for interest on any Note.

10.2. The Company covenants that if default be made in any payment of principal, sinking fund or interest under any Note it will, to the extent that it may lawfully promise so to do, pay to the holder of such Note such further amount as shall be sufficient to cover the cost and expense of collection, including reasonable compensation to the attorneys of the holder for all services rendered in that connection.

10.3. The Notes are issued upon the express condition, to which each successive holder expressly assents and by receiving the same agrees, that no recourse under or upon any obligation, covenant or agreement of this Agreement or the Notes, or for the payment of the principal of, or the interest on, the Notes, or for any claim based on this Agreement or the Notes, or otherwise in respect thereof, shall be had against any incorporator or any past, present or future stockholder, officer or director, as such, of the Company or of any successor corporation, whether by virtue of any constitution, statute or rule of law or by any assessment or penalty or otherwise howsoever, all such individual liability being hereby expressly waived and released as a condition of and as part of the consideration for the execution and issue of the Notes; provided, however, that nothing herein shall prevent enforcement of the liability, if any, of any stockholder or subscriber to capital stock upon or in respect of capital stock not fully paid up.

10.4. No course of dealing between the Company and the holder of any Note or any delay on the part

of any holder in exercising any rights under any Note shall operate as a waiver of any rights of any holder of a Note.

10.5. This Agreement and the Notes shall be governed by the laws of the State of New York.

10.6. Notwithstanding any provision to the contrary in the Notes contained, the Company will pay all amounts payable to you in respect of the principal of, or premium or interest on, any of the Notes at your home office, at the address to which this Agreement is directed, or at such other address as may be designated in writing by you.

The Company has noted that all such amounts are payable in cash at the dates specified, and you have informed the Company that checks payable in funds other than those current at the place of payment will not be acceptable in lieu of cash unless received sufficiently in advance to become current funds at such dates.

All computations of interest for interim periods hereunder or under the Notes are to be made on the basis of a year of three hundred sixty-five (365) days.

The Company will promptly and punctually pay the interest on any Note held by you without any presentment of the Note and without any notation of such payment being made on the Note.

In connection with the making of any payment of principal you will make any Note available to the Company at your home office at any time during your regular business hours on the day such payment of principal is due if the Company shall have

so requested at least fifteen days prior to such day, for the purpose of permitting the Company to make appropriate notation thereon, to the extent not theretofore made, of the amount of principal paid thereon. If the Company shall not make appropriate notation of any payment of principal on any Note held by you at the time such payment is made, you will promptly at the request of the Company make such notation.

In the event you shall sell any Note you will, prior to the delivery of such Note, make a notation thereon of the date to which interest has been paid on such Note and, if not theretofore made, a notation thereon of the extent to which any payment has been made on account of the principal thereof.

10.7. The Company agrees that after the execution and delivery of this Agreement and so long as you shall hold any of the Notes or any of the New Notes, you shall have the right at your own expense to visit and inspect under guidance of the Company the properties of the Company and its Subsidiaries, to examine their books of account and to discuss their affairs, finances and accounts with, and be advised as to the same by, their officers, all at reasonable times and at reasonable intervals.

10.8. The Company agrees to reimburse you for your out-of-pocket disbursements in connection with the sale contemplated by this Agreement, including the reasonable fee of Messrs. Bainton, McNaughton, Douglas & Leiby and the out-of-pocket disbursements of such firm, in connection with the transaction contemplated by this Agreement.

10.9. The Company will pay any stamp taxes which may be payable in respect of the issue of the Notes, and its agreement in this connection shall survive the payment or prepayment of the Notes.

10.10. The descriptive section headings and paragraph headings herein have been inserted for convenience only and shall not be deemed to limit or otherwise affect the construction of any provision hereof.

10.11. All covenants, agreements and representations made herein and in certificates delivered in connection with the closing hereunder by or in behalf of the Company shall survive the execution and delivery of the Notes to you and payment therefor and shall bind and enure to the benefit of the successors and assigns of the Company, whether so expressed or not, and all such covenants, agreements and representations shall enure to the benefit of your successors and assigns, and to the benefit of all future holders of the Notes, whether so expressed or not, provided that the provisions of Paragraphs 4.2, 4.3 and 10.7 shall not be assignable.

10.12. This Agreement may be executed in any number of counterparts and all said counterparts executed and delivered each as an original shall constitute but one and the same instrument.

10.13. All communications provided for hereunder or in the Notes shall be in writing, mailed or delivered to the respective addresses set forth above, or such other address as may be designated in writing by the party to receive such notice, marked, if to you, for the attention of your Vice-President and

Manager of Securities Investment and if to the Company, for the attention of the President. In the event that the Note purchased by you, or any Note or Notes exchanged therefor, shall be transferred by you to another owner, such new owner shall register its address with the Company and thereafter such new owner shall be entitled to receive copies of all notices to be delivered hereunder.

10.14. This Agreement has been dated February 1, 1949, for convenient reference, but was actually delivered on the date shown in the form of acceptance below.

If the foregoing is satisfactory to you, please sign the form of acceptance on the enclosed counterpart of this letter and forward the same to the Company, whereupon this letter will become a binding agreement between you and the Company.

Very truly yours,

LESLIE SALT CO.,

By FRED B. BAIN,

President.

[Seal] SHELDON ALLEN,

Secretary.

The foregoing agreement is hereby accepted this 15th day of February, 1949.

THE MUTUAL LIFE INSURANCE COMPANY OF NEW YORK,

By STUART F. SILLOWAY,

Vice-President.

[Endorsed]: Filed November 24, 1952.

PLAINTIFF'S EXHIBIT No. 7

U. S. Treasury Department
Washington 25.

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and Refer to ExT:M:AHG Cl. A-45354

July 20, 1951.

Leslie Salt Company,
505 Beach Street,
San Francisco 11, California.

Gentlemen:

Consideration has been given to your claim for refund of documentary stamp tax in the amount of $4,400.00 assessed and paid with respect to the issuance by you of instruments designated "promissory notes" in the aggregate principal amount of $4,000,000.00.

Your claim is based on the contention that the above-mentioned notes do not come within the classes of instruments subject to tax under the provisions of section 1801 of the Internal Revenue Code.

The question involved is whether such instruments constitute debentures within the meaning of section 1801 of the Code and are accordingly taxable upon issue.

Under date of February 1, 1949, you entered into separate loan agreements with The Mutual Life Insurance Company of New York and the Pacific

Mutual Life Insurance Company, in which (1) The Mutual Life Insurance Company of New York agreed to purchase from you a note dated February 1, 1949, in the principal amount of $3,000,000.00, and (2) the Pacific Mutual Life Insurance Company agreed to purchase from you a note dated February 1, 1949, in the principal amount of $1,000,000.00. On February 15, 1949, the insurance companies purchased the notes in question at 100 per cent of the principal amounts, plus interest from February 1 to February 15, 1949. The notes bear interest at the rate of 3¼ per cent per annum, and will mature on February 15, 1964. The loan agreements provide for obligatory and optional prepayments on the principal of the notes and for acceleration of the maturity date of the notes upon the occurrence of specified events of default.

Under the terms of the loan agreements you are restricted with respect to other corporate financing and in the modification of your corporate structure. You are also restricted in the declaration of dividends, in the purchase or retirement of any of your capital stock and in the disposition of your assets. You are required to maintain a net working capital at all times of not less than $1,000,000.00. Periodically, you are required to furnish to the insurance companies certain financial statements of your corporation. At the time the loans were made you were required to furnish the insurance companies with opinions of your counsel covering a number of matters, including opinions to the effect that the agreements and the notes constitute valid and legally binding obligations of your corporation. The in-

surance companies represented that they were acquiring the notes for their own accounts and not with a view to sale or distribution thereof. The proceeds of the loan were used by you to retire outstanding bank loans and to finance certain construction work.

In the case of General Motors Acceptance Corporation v. Higgins (161 Fed. (2d) 593, Ct. D. 1708, C. B. 1948-2, 157; certiorari denied, 332 U. S., 810), it was held that certain instruments termed "notes" should be classified as "debentures" without regard to the name by which they are called. The Court held that the type of instruments there involved fell within a "class apart from ordinary commercial promissory notes and into the category of debentures as that term is used in the statute in its setting with bonds, and certificates of indebtedness, to designate a type of corporate securities which does not include ordinary promissory notes."

It is held by the Bureau that the instruments issued pursuant to the agreements involved in the present case create rights and liabilities not commonly associated with promissory notes. By their terms and provisions, the instruments represent a method of financing common to debentures, which is similar to that type of financing accomplished through the medium of a public issuance of investment securities under an indenture. Moreover, the instruments were issued by you as corporate borrower to obtain capital for use in your business under conditions similar to the sale of bonds, debentures, or other investment securities. The fact

that the borrowing is effected through one or more lenders, rather than the general public, is not material to the question here at issue.

The facts in this case, including the circumstances under which the notes were issued and the conditions of the loans, have all been very carefully considered by the Bureau. From an over-all standpoint and not based upon any particular factor or condition, it is held by the Bureau, in the light of the decision in the General Motors Acceptance Corporation case, supra, that the instruments involved in the present case should be classed as debentures. This conclusion is consistent with the position of the Bureau in other cases involving substantially similar facts. Moreover, this conclusion is sustained by the decision of the United States District Court for the District of Maryland, rendered October 24, 1950, in the case of Commercial Credit Company v. Hofferbert, Collector (93 Fed. (Supp.) 562), which was affirmed on May 7, 1951, by the Circuit Court of Appeals for the Fourth Circuit. Accordingly, the issuance of the notes in question is subject to the tax imposed by section 1801 of the Code.

In view of the foregoing, your claim is rejected in full.

Very truly yours,

GEORGE J. SCHOENEMAN,
Commissioner.

By /s/ CHARLES J. VALAER,
Deputy Commissioner.

[Endorsed]: Filed November 24, 1952.

138 *Minute entry of argument and submission*

[omitted in printing].

December 15, 1954

139 In United States Court of Appeals for the Ninth Circuit

Order directing filing of opinion and filing and recording of judgment

December 16, 1954

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the Clerk, and that a Judgment be filed and recorded in the minutes of the Court in accordance with the opinion rendered.

140 In United States Court of Appeals for the Ninth Circuit

No. 13873, Dec. 16, 1954

UNITED STATES OF AMERICA, APPELLANT

v.

LESLIE SALT COMPANY, APPELLEE

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTHERN DIVISION

Opinion

Filed December 16, 1954

Before HEALY and BONE, Circuit Judges, and DRIVER, District Judge

HEALY, Circuit Judge.

This is a suit to recover taxes exacted under 26 U. S. C. A. §§ 1800 and 1801.

Section 1801 in material part provides: "Corporate securities. On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 11 cents."

The transactions in question were two loans negotiated by the taxpayer in 1949 with insurance companies in amounts of

$1,000,000 and $3,000,000, evidenced in each instance by a non-negotiable promissory note for the full amount maturing in 15 years. Underlying each note was an agreement on the part of the borrower containing restrictions designed for the protection of the lender. No interest coupons were attached to the instruments. They were not on vellum or parchment nor were
111 they engraved, and the trial court found that they were not issued in registered form. The latter finding was not protested in the government's opening brief or in the oral argument of its counsel. The court held that the instruments were not of the type designated by the statute and are not subject to stamp tax thereunder. The opinion of the court is reported in 119 F. Supp. 680.

We are not prepared to say that the decision is wrong. There is no satisfactory evidence that Congress intended to tax instruments of this character—certainly none that it did so in anything approaching clear language. It is altogether likely that had Congress foreseen the development of corporate financing by means of large long-term placement loans like these it would not have repealed outright the statutory tax it had imposed during the first World War on promissory notes, but would have modified the statute to conform with the development. Congress has since had abundant opportunity to legislate on the subject but has not seen fit to do so. We can not but feel that in the considerable number of instances where courts have upheld exactions of the tax in situations analogous to the present they have invaded a field belonging exclusively to Congress.

In going one way or the other the judges have frequently relied on distinctions which appear to us to be without difference, mainly on whether the loan was negotiated with an insurance company or whether it was negotiated with a commercial bank. We may add that subsequent to the opinion below several decisions have come down, heading, as was inevitable, in all directions. The chief of these more recent efforts is the Second Circuit case of Niles-Bement-Pond Co. v. Fitzpatrick, 213 F. 2d 305. There the court, in lokling for the taxpayer, wrestled with the unpleasant if not impossible task of distinguishing an earlier opinion of its own. Fortunately we are confronted with no problem of that nature.

Affirmed.

[File endorsement omitted.]

142 In United States Court of Appeals for the Ninth Circuit

No. 13873

UNITED STATES OF AMERICA, APPELLANT

v.

LESLIE SALT COMPANY, APPELLEE

Judgment

Filed and entered December 16, 1954

Appeal from the United States District Court for the Northern District of California, Southern Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Northern District of California, Southern Division, and was duly submitted.

On consideration whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this cause be, and hereby is affirmed.

[File endorsement omitted.]

143 [Clerk's certificate to foregoing transcript omitted in printing.]

144 Supreme Court of the United States

[Title omitted.]

Order extending time to file petition for writ of certiorari

Upon consideration of the application of counsel for petitioner,

It is ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including May 14, 1955.

Wm. O. Douglas

WM. O. DOUGLAS,

Associate Justice of the Supreme Court of the United States.

Dated this 3d day of March 1955.

No. 493, October Term, 1954.

[Title omitted.]

Order allowing certiorari

Filed June 6, 1955

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE 1955